Before The
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Petitions of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers Regarding Access Charges and the "ESP Exemption"	)	Docket No. 08-152

COMMENTS OF PAC-WEST TELECOMM, INC.

Pac-West Telecomm, Inc. ("Pac-West") hereby submits its comments on the ""Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers" ("AT&T Petition") filed in the above-captioned matter on July 17, 2008. For the reasons set forth below, the AT&T Petition should be denied in its entirety. In support whereof, Pac-West respectfully states as follows:

I. INTRODUCTION AND SUMMARY

Pac-West is a Competitive Local Exchange Carrier ("CLEC") headquartered in Oakland, California. Using its facilities-based network of switching equipment and fiber optic transport facilities, Pac-West provides advanced services in its regional operating territory consisting of the states of California, Oregon, Washington, Arizona, Idaho, Utah and Nevada. Pac-West currently serves approximately 225 customers from various market segments, including Internet Service Providers (ISPs), Voice Over IP (VOIP) Providers, Enhanced Communication Service Providers (ESPs), International Telephone Carriers, Long Distance Carriers, Local Exchange Carriers, Fax Service Providers, Termination Aggregation Providers and Direct Service Providers of communication services to business or residential end-users (SPs). These Pac-West service provider customers in turn serve over two million end user customers.

For many of the reasons stated in the AT&T Petition, Pac-West supports comprehensive reform of the current intercarrier compensation system. Pac-West has experienced first hand the business uncertainties and the need to expend extraordinary litigation resources caused by the lack of clarity and equity embodied in current industry practices implementing reciprocal compensation and access charges. Such realities have a far larger proportional impact on a small CLEC like Pac-West than on its larger competitors like AT&T and other Incumbent Local Exchange Carriers ("ILECs") and their assortment of affiliates that take advantage of the very rules AT&T decries. So Pac-West supports comprehensive reform, and supports its adoption by the Commission at the soonest time it can be carefully and fully completed.

Pac-West's experience with the present system proves, however, that it is far more important that this reform be done right than that it be done to meet an unrealistic deadline. If the new system is internally inconsistent, contains vaguely drafted provisions, or relies on subsequent decisions or litigation, it will do little to address many of the woes concerning the present system expressed by AT&T in its Petition. The only firm deadline now in effect that impacts a component of this comprehensive reform is the mandate of the D.C. Circuit Court of Appeals in the *In re Core* matter,[1] requiring the Commission to respond by November 6, 2008, to its remand of the Commission's 2001 *ISP Remand Order*.[2] In a subsequent filing in the appropriate proceeding Pac-West will discuss its position on the proper response to the Court in the *Core* proceeding. If a comprehensive reform plan can be completed by then, all the better. If not, then the Commission should continue diligent efforts to complete it properly as soon thereafter as possible.

---

[1] *In re Core Communications, Inc.*, No. 07-1446, 2008 U.S. App. LEXIS 14501 (D.C. Cir. 2008).

[2] *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 96-98; CC Docket No. 99-68, *Order on Remand and Report and Order*, 16 FCC Rcd 9151 (2001)("*ISP Remand Order*").

However, Pac-West strongly opposes actions by the Commission that are anything less than comprehensive, and that do not constitute true and long term reform. Such requests merely divert resources from the ultimate goal. As other parties have pointed out, there have been decades of "interim" partial modifications to the system, intended as temporary measures but that have persisted for years.[3] The relief requested by the AT&T Petition falls squarely in line with this history of proposals to insert a few more fingers in the leaking dike. In addition to diverting attention from the important comprehensive issues, AT&T, as might be expected, only proposes to plug those holes that it thinks are flooding its own house. It pays no attention to significant problems the existing system causes CLECs like Pac-West, and entirely ignores those components of the present system which provide it with massive economic benefits.

For example, the AT&T Petition ignores the economic consequences of the fact that its wireless affiliate and other CMRS providers do not pay access charges for a large portion of their traffic terminated to the PSTN, and that the volume of this traffic dwarfs the volume of that VOIP traffic AT&T asks be made subject to access charges that its own CMRS affiliate will continue to avoid. The AT&T Petition ignores the fact that AT&T itself offers VOIP service to residents and businesses at flat rates that cannot reflect access charge costs. The AT&T Petition ignores the fact that AT&T continues to charge its end users the full cost of call termination for calls terminated by CLECs, even though it pays CLECs a much lower price for ISP-bound calls than it collects, thereby overcharging consumers.

Finally, despite its pervasive criticisms of the existing access charge regime, and its advocacy of lower terminating rates generally, AT&T incongruously urges the

[3] Section 251(g) of the Act, 47 U.S.C. Sec. 251(g), reflects an expectation that the then-existing access charge system would be superseded by action of the Commission reflecting the requirement of the 1996 legislation.

expansion of the application of access charges to VOIP services provided by its competitors as another "interim" measure. This would be a backward step, away from unified terminating rates and away from cost based termination charges.

Any comprehensive reform of intercarrier compensation must be premised upon the adoption of cost-based rates. As demonstrated herein, the most accurate and appropriate existing intercarrier local termination rates are those cost-based rates that have been established by the various state public utility commissions, generally after extensive rate making proceedings. These rates are to be contrasted with access charges, with their acknowledged distortive subsidies and lack of alignment with costs, as well as the currently-effective $0.0007 rate adopted in the Commission's 2001 *ISP Remand Order*, which was not based upon any cost analysis then, and has not been validated by any cost analysis since, either by this Commission or any state public utility commission.

Attached hereto as Exhibit A is the Declaration of Dr. Lee L. Selwyn, which addresses the economic and policy considerations raised by the matters summarized above.[4] Dr. Selwyn's declaration fully supports the conclusion that the AT&T Petition should be denied in its entirety.

II. THE COMMISSION SHOULD NOT APPLY ACCESS CHARGES TO INTEREXCHANGE IP/PSTN TRAFFIC.

The AT&T Petition and the related materials filed by AT&T with the Commission on July 17, 2008, are full of repeated criticisms of the current "legacy" access charge system, and describe many of the undesirable consequences of that system. Ironically, AT&T then proceeds to ask the Commission to expand the scope of services subject to

[4] Dr. Selwyn's Declaration also addresses the related question of how the Commission should respond to the recent mandate of the D.C. Circuit in the *Core* case. This Declaration will also be filed in dockets CC 99-68 and CC 01-92. Obviously, the Commission's determinations with respect to ISP-bound traffic should be an integrated component of any comprehensive reform of intercarrier compensation.

this very system to cover a category of traffic – IP/PSTN traffic[5] – to which the Commission has never applied it in the past. The predominant form of IP/PSTN traffic at issue is VOIP traffic. The AT&T Petition fails to address significant negative consequences of such action by the Commission and omits to include material facts which demonstrate why such an expansion of the access charge regime would be anti-competitive and a substantial step backwards, away from a unified comprehensive intercarrier compensation plan.

A. AT&T Provides VOIP Services Offering Unlimited Calling for a Flat Fee That Cannot Include Access Charge Costs

For example, ATT&T fails to discuss the fact that it offers, apparently through an affiliate CLEC or ISP, retail IP/PSTN services, specifically VOIP services, at rate levels and under a rate structure that makes it apparent on its face that the AT&T entity providing this VOIP service is not incurring access charge costs.

Attached hereto as Exhibit B are pages from AT&T's website describing some of its retail VOIP service offerings. It is apparent on the face of these documents that AT&T is marketing and providing retail VOIP services under pricing schemes that make it impossible to assert that the AT&T entity involved is paying access charges for this traffic. For example, Page 1 of Exhibit B describes AT&T CallVantage VOIP service. This service provides unlimited local and long distance calling on up to 4 lines for $50.00 per month. This equates to AT&T revenue of $12.50 per line per month for unlimited local and long distance calling. Assuming that an average AT&T interstate access charge is approximately $0.0090317 per minute (and assuming (1) no access charge is incurred at the originating edge of each call, and (2) AT&T incurs no costs other than

[5] AT&T defines the Petition's use of this term at note 12, page 4 of the Petition. Note, however, that AT&T purports to exclude "dial up ISP bound traffic" from its definition. If an end user dials an ISP using a IP/PSTN or PSTN/IP service, the Petition provides no basis or rationale for excluding such traffic from its access charge proposal, or any practical method for segregating such a call from other similar "IP/PSTN" traffic. In fact, the entire thrust of the Petition supports the proposition that terminating access charges should apply to this traffic.

access charges in providing VOIP service), the $12.50 would pay access charges only for 23 hours per month, or less than one hour per day. Once the customer made any VOIP calls over this amount of time (which any business customer is highly likely to do), not only would access charges not be covered, but neither would any other costs associated with AT&T's provision of this VOIP service.

In contrast, if AT&T's request in its Petition were granted, whenever a Pac-West customer used VOIP service more than one hour a day, each of these additional minutes would continue to incur additional access charges, thus increasing the cost to Pac-West and in turn, its ISP customer and ultimately to the retail end user. This result would provide AT&T an obvious and undeniably significant competitive advantage in the retail VOIP market place. Therefore it is not surprising that AT&T seeks to find regulatory justifications for such additional charges. Any such result is both anti-competitive and inappropriate. The inequity and anti-competitive consequences of this imposition of non-cost based termination charges on VOIP traffic would be even more harmful if this "interim" outcome remained in effect for an extended period in the absence of timely comprehensive reform.[6]

B. AT&T Does Not Propose That Wireless Carriers, Including Its Affiliate, Pay Access Charges

AT&T does not propose the "interim" application of access charges to any of the traffic of its wireless affiliate, AT&T Mobility, or any other wireless carrier. As discussed in detail by Dr. Selwyn in Exhibit A hereto, the continuing exemption of these wireless carriers from the payment of access charges on a substantial portion of their intrastate and interstate long distance traffic provides an economic windfall to AT&T far in excess

[6] Furthermore, if access charges were imposed on VOIP traffic, it is not clear how the Commission would ensure that AT&T actually imposed such charges on itself when offering VOIP services. Even if it did, it is largely payment from one pocket to another, not an external expense as it would be to AT&T's CLEC competitors, thus exacerbating the competitive effect of the non-cost based portions of such access charges.

of any alleged shortfall in revenues incurred by the failure of all VOIP service providers combined to pay access charges.

As explained by Dr. Selwyn:

> The single greatest beneficiaries of existing disparities in the application of switched access charges have been CMRS carriers and, in particular, those affiliated with RBOCs such as AT&T and Verizon. This is because the FCC has expressly exempted most intrastate long distance calls and many interstate long distance calls placed from wireless phones from access charges, permitting the carrier to treat such calls as §251(b)(5) "local" traffic when handing them off to a LEC for termination. To put the effect of this CMRS access charge exemption in its proper context, the Cellular Telecommunications and Internet Association ("CTIA"), the wireless industry trade group, estimates that there are more than 262.5-million wireless phones in use in the US. By contrast, all of the nomadic or "over-the-top" VoIP providers combined serve in the range of 3- to 4-million customers nationwide. Aggregate US wireless industry revenues amount to more than $140-billion annually, roughly 100 times the $1.4-billion or so in annual revenues being reported by the principal "over-the-top" VoIP service providers. The enormous and unique advantages that the AT&T and Verizon derive from this advantageous treatment stems from the FCC classification of wireless-originated calls placed between points within the same Major Trading Area ("MTA") as "local" and therefore subject to reciprocal compensation rather than access charges when terminated to a wireline LEC.[7]

The magnitude of this wireless access charge exemption puts a meaningful perspective on the selective, competitively-targeted nature of the relief being sought by the AT&T Petition. VOIP services compete with wireless services, and the effect of the AT&T Petition, if granted, would be to significantly advantage its large and growing wireless business from competition from VOIP services offered by CLECs like Pac-West. Such piecemeal, potentially long-lived movement away from cost-based termination rates applicable to all services and technologies utilizing the PSTN will not have any beneficial consequence except for the particular companies that benefit from further expansion of ILEC access charge payments by competitors.

[7] Exhibit A, pp. 22-23, footnotes omitted.

III. AT&T SEEKS UNJUSTIFIED REVENUE NEUTRAILITY AS PART OF ITS PETITION

In addition to urging the Commission to apply legacy access charges to competitors' IP/PSTN traffic, AT&T also requests that the Commission grant it authority to increase charges to both its end user customers (subscriber line charges) and its competitors (originating access charges), in order that any reduction in terminating access charge revenues resulting from its proposal would be recovered from these sources. It is highly likely that AT&T's enthusiasm for reduced terminating rates would be severely dampened if it was not accompanied by Commission authorization to be made whole on the originating side.

There are complex and different issues associated with a decision to increase subscriber line charges and originating access rates than apply to the reduction of terminating rates. The Commission should analyze these two circumstances separately and without linkage. For example, it is not clear that increasing charges for use of the PSTN for originating traffic would not drive both carriers and end users to seek alternatives, thus actually decreasing originating revenues to AT&T (unless the end user shifts its usage to AT&T Mobility).

As discussed in detail by Dr. Selwyn in Exhibit A hereto, the Commission should determine that terminating carrier charges should be those charges for local termination established by the various state public utility commissions. These charges have been generally established in detailed rate making proceedings, often involving adversarial hearings. These rates are carrier specific and state specific.

As stated by Dr. Selwyn:

> The only correct solution is to adopt a uniform call termination charge, applicable to all traffic, that is based upon TELRIC. As summarized in Table 1 below, numerous state PUCs have examined and adopted TELRIC-based call termination rates, which are almost uniformly well in excess of the $0.0007 cap being proposed by the ILEC/CMRS coalition. … With respect to AT&T's

> apparent confusion about whether to "raise the bridge" (via its Petition to impose access charges on VoIP traffic) or "lower the water" (via the ILEC/CMRS coalition proposal to lower VoIP and other interexchange termination down to $0.0007), it must be realized that while uniformity is the goal, how it is achieved is not merely a matter of convenience – it must be cost-based.[8]

As Dr. Selwyn's Declaration makes clear, the application of non-TELRIC–based access charges to an additional category of traffic would be in explicit contradiction to the proper goal of comprehensive intercarrier compensation reform. It would ignore available TELRIC local termination rates and instead impose on CLEC VOIP traffic the very legacy access charges its Petition decries.

IV. CONCLUSION

For the reasons set forth above, the AT&T Petition should be denied in its entirety. Instead, the Commission should focus all of its available resources on the long-delayed implementation of a truly comprehensive reform of the current intercarrier

[8] Id. at 28-29. These rates are to be contrasted with the $0.0007 rate established by the Commission's 2001 *ISP Remand Order.* This rate was apparently based upon a negotiated interconnection agreement between AT&T and Level 3. Pac-West does not, of course, object to the negotiation of any voluntary interconnection arrangements between a CLEC and an ILEC, as permitted by Section 252 of the Act. However, such rates are often negotiated in a business context far broader than that eventually set forth in the interconnection agreement, and often reflect various compromises reached by the parties during the negotiations on a range of related and unrelated issues. While acceptable for the carriers involved, such a negotiated agreement is wholly inappropriate as a basis for imposing that rate on other carriers in different business circumstances.

compensation system. The Commission should not adopt any of the piecemeal, self-serving changes to the existing system proposed in the AT&T Petition.

Dated: August 21, 2008

Respectfully submitted,

James M. Tobin
Tobin Law Group
1628 Tiburon Boulevard
Tiburon, California 94920
Telephone: 415-732-1700
Facsimile: 415-789-0276
E-Mail: jim@tobinlaw.us

Attorneys for Pac-West Telecomm, Inc.

EXHIBIT A

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of	
Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers	WC Docket No. 08-152
Developing a Unified Intercarrier Compensation Regime	CC Docket No. 01-92
Intercarrier Compensation for ISP-Bound Traffic	WC Docket No. 99-68

Declaration of

LEE L. SELWYN

submitted on behalf of

PAC-WEST TELECOMM, INC.

August 21, 2008

TABLE OF CONTENTS

Figures

Tables

Attachments

DECLARATION OF LEE L. SELWYN

I. Introduction

1. My name is Lee L. Selwyn; I am president of Economics and Technology, Inc. ("ETI"), based in Boston, ETI is a research and consulting firm specializing in telecommunications economics, regulation and public policy. I have submitted testimony before the Commission on numerous occasions dating back to the late 1960s, and have appeared before the Commission at several *en banc* hearings. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof.

2. I have been asked by Pac-West Telecomm, Inc. to address the economic and policy implications arising from the *Core Comm* mandate and the AT&T *Petition for Waiver*, and to consider whether or not the interim piecemeal relief being sought by AT&T will serve the broader Commission objective of establishing a comprehensive, cost-based and nondiscriminatory approach to intercarrier compensation.

II. The existence of the Core Comm mandate underscores the fallacy of the piecemeal treatment of intercarrier compensation reform that has characterized the Commission's approach to this issue and that would be exacerbated if AT&T's Petition for Waiver were granted

3. It is undisputed that under the intercarrier compensation scheme that has been in existence at least as far back as the 1996 federal Telecommunications Act, different and disparate charges and charging mechanisms are imposed for what are basically identical transport and termination

services based upon the nature of the call, the nature of the carrier, and the technology being used to provide the service. Up to this point, the Commission has addressed the issue of intercarrier compensation on a piecemeal basis, applying service- and/or technology-specific treatments on a case-by-case basis. In some instances, such measures have been described as "interim" in nature, to ultimately be harmonized in the context of a comprehensive intercarrier compensation reform. Unfortunately, however, many of these "interim" solutions have taken on more permanence than the Commission may have initially intended and, in any event, have failed entirely to converge upon a comprehensive cost-based, economically efficient, competitively- and technology-neutral paradigm. The Commission's 2001 *ISP Remand Order*,[1] which is the focus of the mandate issued by the Court of Appeals for the District of Columbia Circuit (*Core Communications v. FCC*),[2] is the latest incarnation of the dispute arising from the Commission's disparate treatment of one particular category of traffic – ISP=bound calls.

4. The Court's mandate requires that the Commission address the *WorldCom Remand* no later than November 5, 2008 and provide the Court with yet another legal basis for its decision to treat ISP-bound calling differently from other §251(b)(5) local traffic. In the aftermath of that mandate, the Commission has received multiple recommendations for immediate intercarrier

1. *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 96-98; CC Docket No. 99-68, *Order on Remand and Report and Order*, 16 FCC Rcd 9151 (2001)("*ISP Remand Order"*).

2. *In re Core Communications, Inc.*, No. 07-1446, 2008 U.S. App. LEXIS 14501 (D.C. Cir. 2008).

compensation reform that go well beyond the scope of the Court's directive. While there is widespread support for comprehensive intercarrier compensation reform, the appeals for short-term fixes to particular segments of the overall regime would, like the original *ISP Remand Order* itself, fail to converge on a comprehensive solution and, at best, would introduce additional distortions and discriminations without actually resolving existing ones. Comprehensive reform is warranted but the kind of piecemeal and largely self-serving "solutions" being sought by AT&T and other similarly situated incumbent wireline and wireless carriers do not lead to the ultimate objective. Yet in filing its Petition, AT&T is conceding that achieving the goal of comprehensive intercarrier compensation reform by November 5, 2008 is not realistic. Accordingly, for the present, the Commission should maintain its focus on the specific mandate from the Court, and use this opportunity to put an end to the discriminatory and disparate treatment of ISP-bound traffic. Thereafter, the Commission should address and resolve the full range of issues and interests pertaining to intercarrier compensation as expeditiously as possible.

5. In the seven years since the Commission implemented its interim rules that capped the termination rates for ISP-bound calls at levels well below those for other Section 251(b)(5) traffic, dial-up Internet use has declined substantially as customers migrated from dial-up to high-speed Internet access. According to the latest FCC *High-Speed Services for Internet Access* Report (as of June 2007), the number of residential customers with broadband Internet connections (primarily ADSL and cable modem service) increased from 4.3-million in June

2001 to 61.1-million as of June 2007.[3] Thus, reinstating rate parity on a going-forward basis should raise few, if any, concerns with respect to its revenue impacts. Equally if not more important, the alternative of dial-up Internet access continues to serve a key role in meeting the needs of certain segments of the population that do not have or cannot obtain high-speed access, including low-income and rural customers. Accordingly, the Commission should adopt an appropriate decision finding that, due to changed industry circumstances, the continued enforcement of the 2001 *ISP Remand Order* is not in the public interest, and so advise that Core Comm Remand Court.

6. For the reasons set forth below, the Commission should put an end to the interim rules that have artificially distinguished presumed ISP-bound traffic from other Section 251(b)(5) traffic. The Commission never fully justified this artificial distinction, and has never established any cost justification for the $0.0007 per minute rate cap it has imposed for termination of ISP-bound calls. Although the Commission has twice attempted to legally justify its decision to treat presumed ISP-bound traffic differently from other Section 251(b)(5) – reciprocal compensation – traffic, the FCC has so far failed to convince the Court of this distinction.

7. Moreover, the rules, intended to be in place for a limited time, are based upon presumptions and proxies that have never been adequately examined. Notably, while the 3-to-1 rule establishes a presumption that where there is an imbalance of terminating-to-originating traffic,

3. FCC Industry Analysis and Technology Division, Wireline Competition Bureau, *High-Speed Services for Internet Access: Status as of June 30, 2007*, issued March 2008, at Table 4.

the customer is an ISP, there are many other types of customers who could exhibit this traffic pattern. Likewise, the selection of the rate cap of $0.0007 – 3 to 5 times lower than the proxy range of $0.002 to $0.004 that the Commission had established for reciprocal compensation[4] and that numerous state PUCs have found to be an appropriate TELRIC-based call termination rate[5]– appears to have been more a matter of expediency than of cost analysis. The $0.0007 rate came from one of several existing *negotiated* interconnection agreements,[6] and the Commission did not make any independent analysis of the cost basis for the rate or evaluate how this particular amount compared to reciprocal compensation rates that were the result of §252 state commission arbitrations and other ratesetting proceedings. The Commission certainly did not conduct any analysis that would justify a conclusion that the "additional costs" associated with such traffic are zero (a prerequisite for adopting bill-and-keep in the absence of equal traffic flows).[7] The

4. 47 CFR § 51.707, *Default proxies for incumbent LECs' transport and termination rates.*

5. See Table 1, *infra.*

6. Because of the ILEC's unequal bargaining power, the negotiated interconnection agreements from 2000/2001 likely were entered into by CLECs that preferred an expedient contracting process to the lengthier and more complicated process of arbitration. However, during this period, many of the largest CLECs preferred to use arbitration to obtain a cost-based rate – and these were generally significantly higher than the $0.0007 that the Commission chose as its proxy rate. Significantly, the $0.0007 rate was part of a negotiated settlement that, like any settlement, may well have involved tradeoffs in other areas. The Commission's aAdoption of this one particular feature of a massive interconnection agreement in isolation from all other elements thereof amounts to cherry-picking and in no sense provides a basis for or validation of the $0.0007 rate cap.

7. As discussed in more detail below, the Commission essentially admitted that a LEC's costs for transport and termination exceeded "zero" when it suggested that these costs could be recovered by the LEC from its customer. *ISP Remand Order,*16 FCC Rcd 9151, 9156.

result of the Commission's ruling has been that, for seven years, LECs have been compensated at a rate that has never received careful scrutiny.

8. Rather than stretch to devise yet another legal theory to support this discrimination, the Commission should accede to expiration of the remaining portions of its seven-year-old interim rules, such that the compensation for presumed ISP-bound traffic once again aligns with other traffic transported and terminated by a LEC. Nothing in this course prevents the Commission from then pursuing the course of action that it claims to have intended from the start – to incorporate this traffic into a comprehensive, cost-justified approach to intercarrier compensation for all traffic.

III. Policy concerns from 2001 are largely mitigated by industry changes in the intervening period

9. Even if the Commission were to conclude that there a thus-far-overlooked legal justification for the rules adopted in 2001, there is good cause to abandon – on a going-forward basis – those portions of the interim rules that remain in effect, and to restore the reciprocal compensation rates for ISP-bound traffic to parity with other Section 251(b)(5) traffic. Making this change on a prospective basis only would also respond to objections that may be raised about the financial impact of reinstating TELRIC-based reciprocal compensation rates retroactive to 2001 – although, in reality, the mergers (e.g., AT&T, MCI) and many bankruptcies

that have occurred over the past seven years would already ensure that most of any retroactive liability would, in fact, not actually have to be paid out.[8]

10. Over the more than seven years since the Commission had originally adopted the "interim" treatment of ISP-bound traffic (and nine years since its original Declaratory Ruling), the industry has undergone extensive changes that have resulted in a precipitous decrease in the amount of ISP-bound traffic that is subject to transport and termination by LECs on non-dedicated facilities. The two largest CLECs – and IXCs – MCI and (the former) AT&T, no longer exist, and among the next tier of CLECs, many have either gone under or are only now emerging from bankruptcy. Additionally, dial-up ISP-bound traffic has declined dramatically as consumers have migrated to Internet services accessed over dedicated broadband connections. As dial-up Internet access traffic has been suppressed, so would the financial impact associated with paying undiscounted reciprocal compensation rates.

11. In fact, it is very likely that the Commission's interim rules hastened the migration of certain customers away from the dial-up platform. Since requiring CLECs to look to their ISP customers to recover costs that should have been covered in reciprocal compensation – and thus

8. The largest of the CLECs that were delivering dial-up traffic to ISPs in 2001 have, in the intervening period, either been bought by the ILECs (AT&T and MCI) or gone bankrupt or out of business (e.g., ICG, Allegiance, XO, Pac-West). Obviously, whatever "liability" AT&T and Verizon would have to their own affiliates has no direct financial impact. For some CLECs like Pac-West that have emerged from bankruptcy and are still in business, although bankruptcy may have capped preexisting liabilities, these firms may also be precluded from looking to recoup "assets" associated with their pre-bankruptcy period.

raising ISPs' costs – the new pricing structure for ISP-bound traffic helped to hasten the migration of customers from dial-up to broadband Internet access. At the same time, by taking advantage of their "sunk' costs in copper loop plant and pricing DSL incrementally, the ILECs were able to offer dedicated access via DSL at relatively low rates. So while the ILECs were shifting dial-up costs to independent ISPs, they were exploiting their embedded infrastructure and embedded subscriber base to bootstrap their way into the ISP business. It is not surprising, then, that in the interval since the Commission's *ISP Remand Order* and present, much of ISP-bound traffic is no longer handled on a dial-up basis but rather over dedicated ILEC and cable incumbent facilities.[9]

While dial-up Internet access has decreased significantly since 2001, it still remains a viable and economic option for many consumers for whom broadband access is either unavailable or unaffordable

12. At various times since its 2001 *Order*, the Commission has acknowledged that it is appropriate to reevaluate its rules in light of current industry conditions. For example, in its

9. Moreover, with respect to their provision of broadband Internet access, these operators are deemed to operate outside the Commission's Title II supervision. *See, In the Matters of Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, CC Docket No. 02-33, 20 FCC Rcd 14853, 14858 (2005) ("Consistent with the Supreme Court's opinion in *NCTA v. Brand X*, we determine that facilities-based wireline broadband Internet access service is an information service"); *see also, National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 125 S. Ct. 2688 (2005), aff'g *Inquiry Concerning High-Speed Access to the Internet Over Cable and Other Facilities, Internet Over Cable Declaratory Ruling, Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, GN Docket No. 00-185 & CS Docket No. 02-52, *Declaratory Ruling and Notice of Proposed Rulemaking*, 17 FCC Rcd 4798 (2002).

2004 *Core Forbearance* decision,[10] the Commission decided that the trend toward decreasing dial-up traffic (as broadband Internet access expanded) made it appropriate to forbear from enforcement of the "new markets" rule. But while the trend in dial-up minutes has continued downward,[11] the Commission should not assume that it is good public policy for this decline to continue. As described below, dial-up Internet access remains an important alternative to broadband, especially for customers for whom broadband is unavailable or unaffordable. Pac-West firmly believes that the interim rules, by establishing below-cost compensation for presumed ISP-bound traffic, impede the efficient provisioning and potential additional investment in dial-up Internet access alternatives that should be continuing to play a vital economic role as part of consumers' range of Internet access options

13. Broadband deployment is neither universal nor uniformly available. As documented in a recent study by the Pew Internet & American Life Project, dial-up access is still relied on, and

---

10. *Petition of Core Communications, Inc. for Forbearance Under 47 U.S.C. § 160©) from Application of the ISP Remand Order*, WC Docket No. 03-171, 19 FCC Rcd 20179 (2004), affirmed *In Re Core Communications, Inc.*, 455 F.3d 267 (D.C. Cir. 2006).

11. In a recent *ex parte* filing, Qwest admits that it delivered approximately 40% fewer ISP-bound minutes in 2007 than in 2005. Qwest *ex parte* submission, April 25, 2008 (re: CC Docket Nos. 96-98 and 99-68; WC Docket No. 07-135), slide presentation at 6. While Qwest speculates that this trend would be reversed if reciprocal compensation for ISP-bound calls were reinstated at the same level as voice calls, this conclusion makes no sense. The drop-off in dial-up ISP-bound calls has been driven by the growth in broadband access – and that has been driven by the fact that, for most customers, broadband access is superior to dial-up. Indeed, for the most part, those customers who still use dial-up do so mainly because they have no choice – either broadband is not available, or it's too expensive. Elimination of the rate cap may well make dial-up ISP access more widely available to those who need it; it certainly will not stimulate users to shift back from broadband to dial-up.

relied on disproportionately, by customers poorer citizens and minorities.[12] Among the findings reported:

- There is a sizable gap between what dial-up and broadband users pay for monthly access;[13]
- Dial-up users, as a group, are older and loss well-off economically than broadband users (29% live in households with annual incomes of less than $30,000, compared to 14% of broadband users; 43% of dial-up users are age 50 or older versus 29% for broadband users);[14]
- Residents of rural areas continue to rely disproportionately on dial-up access (30% of dial-up users live in rural areas, compared to 13% of all broadband users).[15]

14. Dial-up access also provides an important alternative to customers in rural areas where broadband is often not available. According to the Pew Study, only 38% of rural Americans had broadband at home, compared to 60% of suburban residents and 57% in urban areas.[16] The fact that rural broadband deployment has lagged behind the deployment in urban and suburban areas is the focus of various state and federal initiatives.[17]

---

12. Pew Internet & American Life Project, *Home Broadband Adoption 2008: Adoption stalls for low-income Americans even as many broadband users opt for premium services that give them more speed*, Washington, D.C., July 2008 ("Pew Internet Access Study").

13. *Id.* at 7-8.

14. *Id.* at 11.

15. *Id.*

16. *Id.* at ii.

17. The Commission's website focuses on "Broadband Opportunities for Rural America," and links to the USDA's Many states have implemented programs to monitor and promote rural

15. Consistent with the Commission's policies that diverse telecommunications options best serve the needs of the diverse population, it is important that dial-up Internet access options continue to be made available at affordable prices. This can only occur, however, when the LECs that are willing to invest in preserving and expanding dial-up services are compensated fairly for their costs in transporting and terminating such traffic.

IV. "Phased-in" alignment of intercarrier compensation rates would replace existing sources of discrimination with new ones, and in any event will not result in meaningful convergence upon an ultimate unified intercarrier compensation regime

16. Prior to the May 2001 *ISP Remand Order*, all calls rated as "local" – which included traditional voice calls within an ILEC local calling area, wireless calls placed to points within the same Major Trading Area, and calls to ISPs that were dialed on a local basis – i.e., where the rating point for the ISP's dial-up access number was within the calling party's local calling area – were considered to be §251(b)(5) "local" traffic and on that basis were subject to "reciprocal compensation" charges per §252(d)(2). In the *ISP Remand Order*, the Commission determined that dial-up calls placed to Internet Service Providers ("ISPs") were *not* §251(b)(5) local traffic notwithstanding their physical similarity to ordinary local calls, but should instead be classified under §251(g) as "information access" traffic.[18] In introducing this distinction, the Commission determined that while §251(b)(5) traffic should continued to be handled on a reciprocal

---

broadband deployment in rural areas. See, e.g., *Understanding Broadband Deployment in Vermont*, Vermont Department of Public Service, February 2007.

18. *ISP Remand Order,* 16 FCC Rcd 9151, 9167.

compensation basis, the new "information access" calling should be transitioned ultimately to a "bill-and-keep" arrangement:

> We acknowledge that carriers incur costs in delivering traffic to ISPs, and it may be that in some instances those costs exceed the rate caps we adopt here. To the extent a LEC's costs of transporting and terminating this traffic exceed the applicable rate caps, however, it may recover those amounts from its own end-users. ... The rate caps are designed to provide a transition toward bill and keep or such other cost recovery mechanism that the Commission may adopt to minimize uneconomic incentives, and no such transition is necessary for carriers already exchanging traffic at rates below the caps. ...[19]

17. The paradigm created by the *ISP Remand Order* envisions a hybrid arrangement whereby *some* calls rated as "local" will be subject to reciprocal compensation when handed-off from one local carrier to another for termination, whereas other local traffic – delivered to ISPs – would be subject to rates ($0.0007, with the possibility of a later decrease to "bill-and-keep") that the Commission acknowledged might be insufficient to cover the costs of call termination as incurred by the receiving carrier.

18. One is reminded of an old parable about a debate in the Irish parliament involving a proposal to switch from driving on the left to driving on the right. As the story goes, a suggestion was made that this be done in stages, starting first with cars and then completing the transition by subsequently extending the new arrangement to buses and trucks. The FCC's

19. *Id.* at 9156.

hybrid reciprocal compensation/bill-and-keep "transition" has substantial commonality with this obviously absurd idea. The Commission concludes (at para. 81) that:

> This interim regime satisfies the twin goals of compensating LECs for the costs of delivering ISP-bound traffic while limiting regulatory arbitrage. The interim compensation regime, as a whole, begins a transition toward what we have tentatively concluded, in the companion NPRM, to be a more rational cost recovery mechanism under which LECs recover more of their costs from their own customers. This compensation mechanism is fully consistent with the manner in which the Commission has directed incumbent LECs to recover the costs of serving ESPs, including ISPs.

Footnotes omitted. The merits of the Commission's tentative conclusion that bill-and-keep might be "a more rational cost recovery mechanism" than a cost-based reciprocal compensation protocol is a matter for consideration in the *Unified Intercarrier Compensation* rulemaking proceeding.[20] However, the problem created by the *ISP Remand Order*'s hybrid compensation arrangement is entirely analogous to the consequences of having cars drive on the right while concurrently allowing busses and trucks to drive on the left. Today, *all* local-rated calls – those placed to points within the calling party's local calling area – are made on a "sent-paid" basis. That is, the caller pays the originating LEC a fee that covers the costs of call origination, interoffice transport (including tandem switching, where required), and call termination. This "sent paid" character of local calls holds whether charging is made on a measured basis (per call or per minute) or on a flat-rate (e.g., per month) basis. Under either rate scheme, the calling party pays for these services, which includes call termination at the receiving end of the call.

---

20. *Developing a Unified Intercarrier Compensation Regime*, CC Docket 01-92, *Notice of Proposed Rulemaking*, 16 FCC Rcd 9610 (2001), *Further Notice of Proposed Rulemaking*, 20 FCC Rcd 4685 (2005).

19. If the call is completed to a subscriber who is also served by the same LEC, that carrier provides all of these services, incurs the costs thereof, and recovers those costs through the (measured or flat-rate) usage charges it collects from the calling party (see Figure 1).

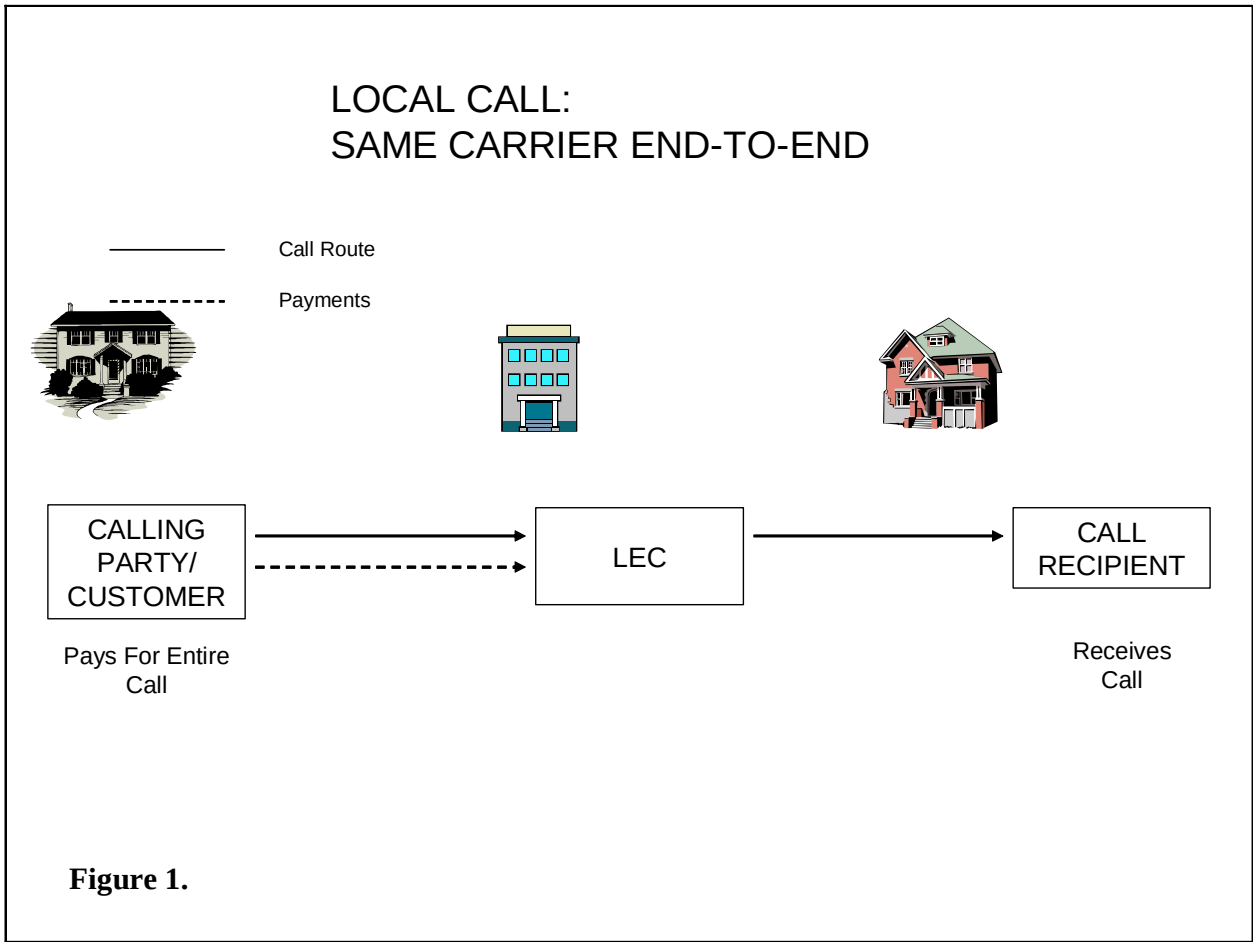


Figure 1.

On the other hand, if the called party is served by a different LEC, the originating carrier *does not* provide the call termination, but instead hands off the call to the other carrier. So long as the called number is in the same local calling area as the calling party, there is no difference in the

charge (to the caller) for the call whether or not it is completed by the same or by a different LEC. In this case, however, rather than incur the costs of termination, the originating LEC compensates the other carrier for *its* costs of termination (Figure 2).

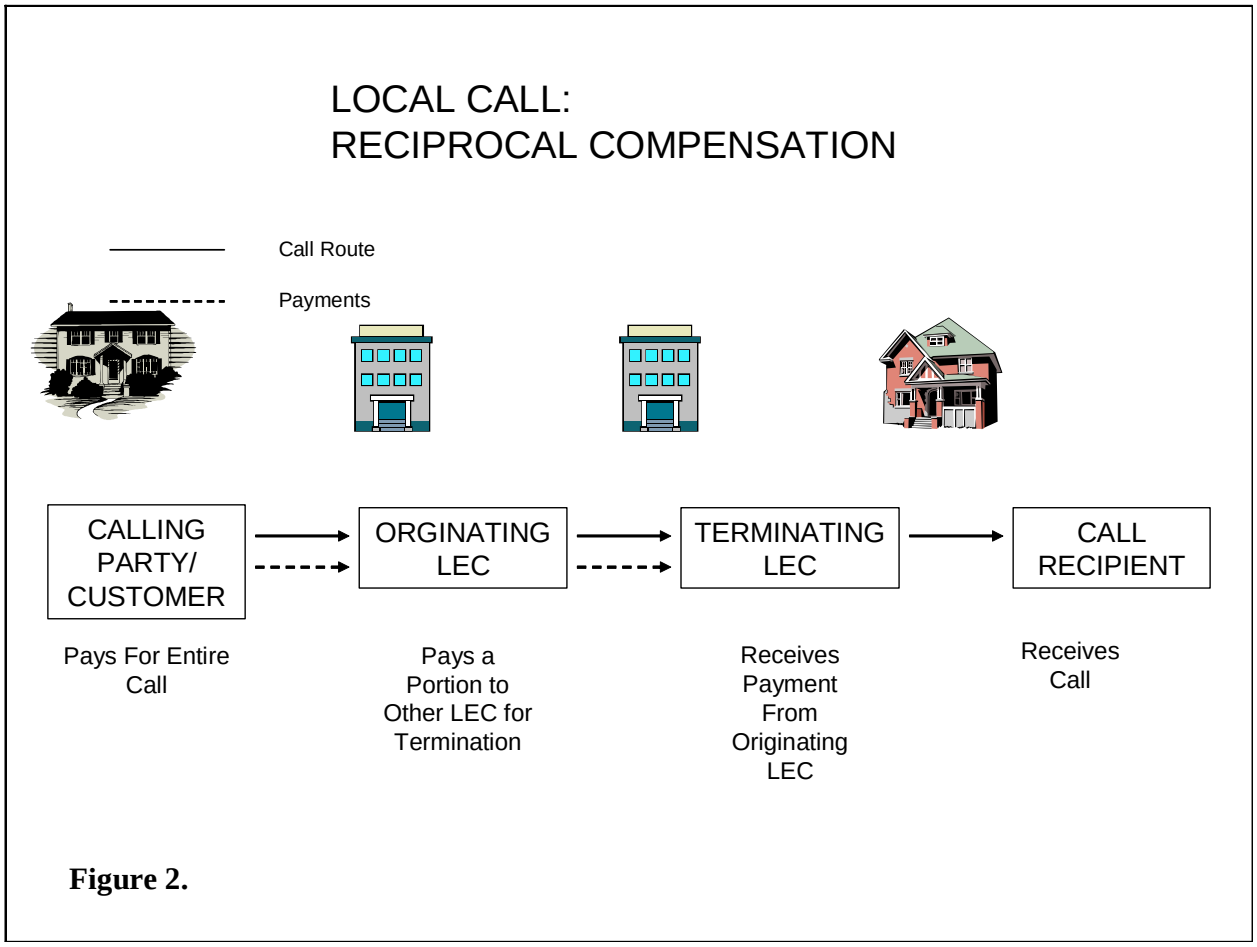


Figure 2.

Importantly, if the call termination rate has been properly set on the basis of forward-looking economic cost – as required by §252(d)(2)[21] and by 47 CFR 51.705[22] – the payment made by the originating carrier to the terminating carrier should be roughly the same as the costs that the originating carrier would have incurred had the same call been terminated on its own network.

20. Now consider the special case of a call placed to an ISP served by a carrier other than the LEC serving the calling party. The charge imposed upon the calling party for the ISP-bound call is *exactly the same* as the charge that applies for a (non-ISP) call. In both cases, the calling party pays for call origination, interoffice transport, and call termination. However, under this hybrid reciprocal compensation/bill-and-keep scheme established by the *ISP Remand Order*, the terminating CLEC is paid a call termination charge by the originating LEC that is *below* the costs of termination, and is expected to recover the difference from its customer – the ISP in this case (see Figure 3). Stated differently, the originating carrier's customer has paid for call termination, but under the *ISP Remand Order* that carrier is not required to pay the terminating carrier the full cost involved in terminating the call, and is thus being permitted to retain a portion of the payment it had received from its customer for call termination as a windfall

21. §252(d)(2) provides that "For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5), a State commission shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless (I) such terms and conditions provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier; and (ii) such terms and conditions determine such costs on the basis of a reasonable approximation of the additional costs of terminating such calls."

22. *See also*, 47 CFR §§ 51.505, 51.511, 51.709.

additional profit. Significantly, AT&T readily acknowledges the notion that the functionalities associated with call termination are essentially identical irrespective of the type of call being terminated: "A prime example of this irrational disparity (but by no means the only one) is the multiple different rates – intrastate access, interstate access, reciprocal compensation – that an incumbent local exchange carrier ("LEC") must charge for performing essentially the same basic function: call termination."

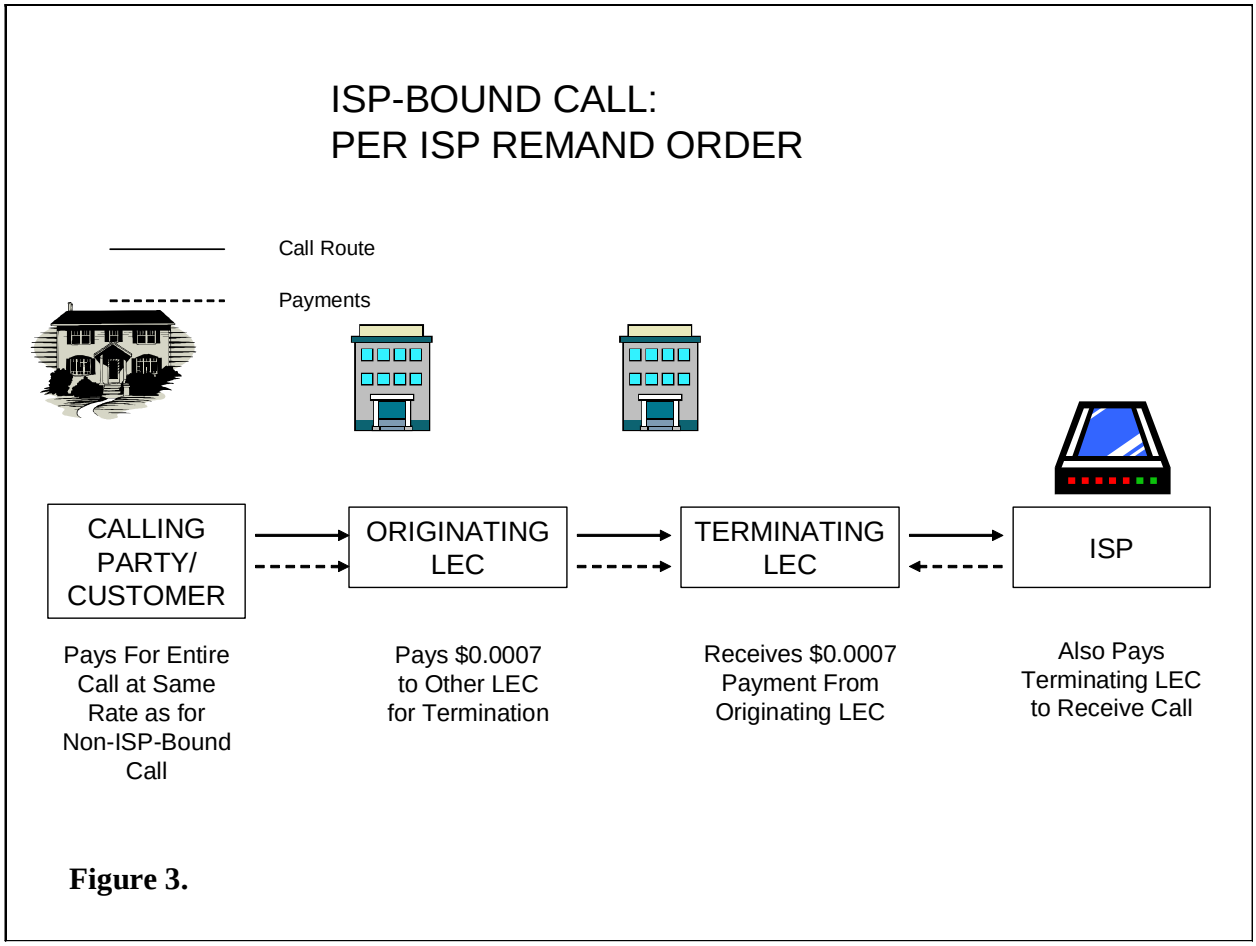


Figure 3.

21. Finally, under a partial bill-and-keep arrangement that is applied solely to ISP-bound traffic, the extent of the double recovery is compounded (see Figure 4). Here, the charge to the calling party for the ISP-bound call is exactly the same as the charge that would be applied for a local call to a POTS customer. However, unlike the case of a POTS-bound call where the originating LEC makes a reciprocal compensation payment to the terminating LEC for delivering the call to the recipient, in the case of an ISP-bound call the originating LEC would make no payment to the terminating LEC. As is illustrated in Figure 4, in this case both the calling party, who placed the sent-paid call to the ISP, and the call recipient – the ISP – would be required to make duplicative payments for the same call termination. Since the originating LEC would avoid the call termination cost altogether, it would be able to retain the revenue it had received from its customer as a windfall profit.

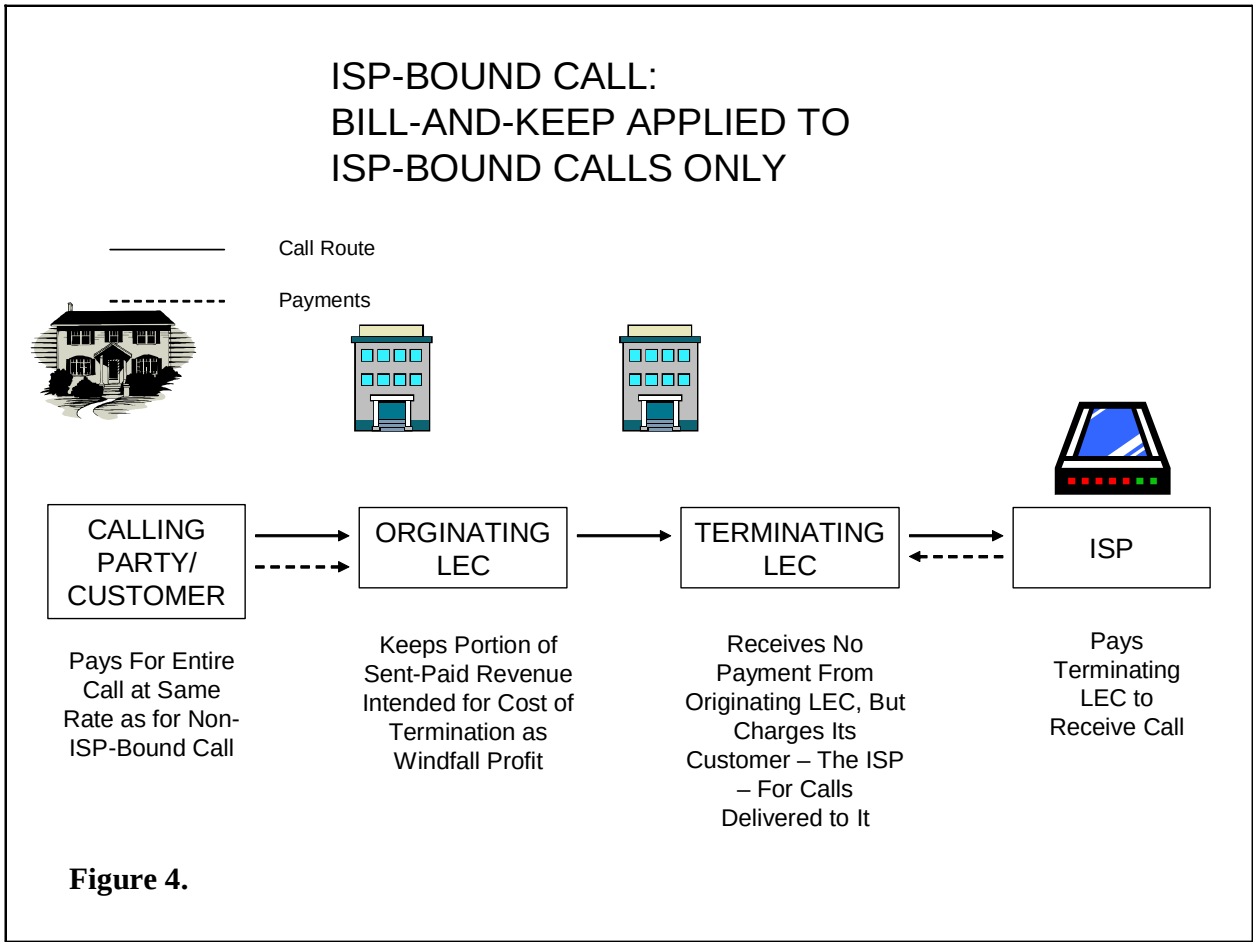


Figure 4.

22. The point is that a partial implementation of bill-and-keep makes no more sense than a partial implementation of driving on the right-hand side of the road. Adoption of a bill-and-keep arrangement not only requires fundamental restructuring of the intercarrier payments mechanisms, it also requires fundamental restructuring of retail service prices. Intercarrier bill-and-keep requires that the calling and called parties each pay for their respective halves of each call.[23] If

23. Importantly, this is precisely the paradigm that has been adopted by CMRS carriers, whose intercarrier compensation arrangement excludes airtime. When a customer of CMRS carrier A calls a customer of CMRS carrier B, the airtime components of the call are treated on a

the Commission believes that the end-game is bill-and-keep, it will need to devise a comprehensive plan for its implementation at both the retail and intercarrier levels, and then accomplish this implementation on a flash-cut basis.

23. Imposing what amounts to a charge to the ISP for *receiving* inbound calls that have been originated on a sent-paid basis by the calling party constitutes double recovery of the same costs. If the ISP is expected to pay for some or all of the costs associated with terminating inbound calls, then the calling party should be afforded a call origination charge for calls to such ISPs that is correspondingly lower than for ordinary voice calls to non-ISP customers.

24. Consider the following analogy. The US Postal Service currently charges 42 cents for a first class letter. As with the charge for a local telephone call, this is a "sent-paid" charge that covers the costs of collecting the mail, transporting it to its destination, and delivering it to the recipient. Certain types of businesses – such as the local phone company – receive large volumes of incoming mail – such as payments for billings sent to their customers. Suppose that, due to these large volumes of incoming mail, the Postal Service decided to apply a " mail delivery charge" of, say, 20 cents. In that event, a total of 62 cents (42 + 20) would have been paid for mail sent to large mail recipients, whereas only 42 cents would have been paid for "ordinary" mail. Assuming that the 42 cent first class mail rate is already more than sufficient to

---

bill-and-keep basis both for intercarrier compensation purposes as well as for retail pricing, whereby each customer (both the caller and the called) pay for their own airtime usage. Extending bill-and-keep to all components of wireline transport and termination would similarly require that each customer pay for transport and termination at their respective ends of each call.

cover the costs of this service, the extra 20 cents would amount to a duplicative recovery. As silly as this may seem, *this is precisely what the FCC has implemented by its requirement that ISPs pay to receive inbound calls when those same calls had already been fully paid for by the calling party*.

25. The FCC's confusion on this point is particularly evident at para. 88 of the *ISP Remand Order*:

> We also are not convinced by the claim of CLECs that limiting intercarrier compensation for ISP-bound traffic will result in a windfall for the incumbent LECs. The CLECs argue that the incumbents' local rates are set to recover the costs of originating and terminating calls and that the ILECs avoid termination costs when their end-users call ISP customers served by CLECs. The record does not establish that ILECs necessarily avoid costs when they deliver calls to CLECs, and CLECs have not demonstrated that ILEC end-user rates are designed to recover from the originating end-user the costs of delivering calls to ISPs. The ILECs point out that, in response to their complaints about the costs associated with delivering traffic to ISPs, the Commission has directed them to seek permission from state regulators to raise the rates they charge the ISPs, an implicit acknowledgment that ILECs may not recover all of their costs from the originating end-user. (footnotes omitted.)

But this does not square with the overarching fact – conceded by AT&T – that all types of call terminations are fundamentally the same. And if all types of call terminations are fundamentally the same, then the cost of terminating a call to an ISP is no different than the cost of terminating a voice call to a POTS customer. In fact, I am not aware of any credible demonstration that the ILECs' cost of providing ISP-bound calls up to the point of interconnection with the CLEC differs from the cost of providing ordinary local voice calls, or that the cost incurred by a CLEC to terminate an ISP-bound call differs from the cost it incurs for terminating a local voice call. If

calls placed to ISPs are functionally equivalent to calls placed to ordinary POTS lines, then contrary to the FCC's concern there is no need for CLECs to "demonstrate[] that ILEC end-user rates are designed to recover from the originating end-user the costs of delivering calls to ISPs" because this must be considered presumptively true.[24]

26. ILECs have long argued that when call termination rates are set in excess of cost, carriers are given the incentive to target customers with high inbound calling requirements – such as ISPs – so as to collect the above-cost call termination charges from the originating LEC. They claim that bill-and-keep will somehow eliminate this perverse incentive. However, bill-and-keep will not eliminate the perverse incentives that ostensibly excessive call termination rates have engendered, it will simply reverse them. Under a so-called "bill-and-keep" arrangement, the call termination charge is effectively set at zero – i.e., *below the cost involved*

---

24. In its ex parte letter of May 9, 2008 (at 5), AT&T asserts:

> Since, as the Commission has found, the ESP compensation regime fully covers the costs of an ISP-serving LEC, permitting that LEC to recover reciprocal compensation for the same services, simply because the traffic originates with another carrier, would entitle it to double recovery. For example, an ILEC serving an ISP would be able to recover both the standard business line rate from the ISP, which theoretically already covers all costs of delivering calls to the ISP, plus reciprocal compensation rates designed to cover those same costs from CLECs that originate calls from the ISP's subscribers. Such double-recovery is no less perverse and unlawful when the carriers' roles are reversed: i.e., when a CLEC serves the ISP and the ILEC serves the ISP's subscribers.

This cannot be squared with the fact that terminating calls to ISPs involves precisely the same functionality as that involved in terminating calls to non-ISP POTS lines. And those costs are fully recovered through the sent-paid charge paid by the caller.

in terminating an inbound call – thereby presenting carriers with the incentive to target customers with high *outward calling* requirements, handing those calls off to other carriers at no cost to themselves. Bill-and-keep works when traffic is roughly in balance, but there is no particular economic reason why traffic should be in balance. There are bulk mailing services that specialize in sending out large quantities of mail while receiving few letters in return, and there are other mailing houses that specialize in receiving and processing large quantities of incoming mail. ILECs have long sought to ascribe malicious or unethical motives to CLECs that do not present balanced inward and outward traffic, but there is no rational basis for such pejorative characterizations. Carriers – particularly entrants with limited network assets and limited capital resources – will necessarily specialize in serving particular types of customers. If they are afforded the ability to hand off calls to others without having to pay them for terminating those calls, they will shift their business models accordingly. The correct solution is not bill-and-keep. The correct solution is a cost-based call termination rate.

27. Finally, if AT&T and other ILECs believe that the TELRIC-based reciprocal compensation charge for terminating ISP-bound calls placed to CLECs is excessive, they certainly have the option – and the ability – to compete for ISP inbound calling business themselves and in so doing avoid making the purportedly excessive call termination payments to CLECs. Indeed, this is the correct "market-based" policy for the Commission to adopt – one that allows the market to sort out the correct price rather than having it dictated by the regulator. Yet ILECs have rarely sought, and today provide only a small amount of, inbound calling services to ISPs. Inasmuch as the current rate cap on ISP-bound calls – $0.0007 – is by the

FCC's own admission below the costs required to terminate such calls, the ILECs' reluctance to compete in this segment is hardly surprising. If established on the basis of forward looking economic costs, a properly set call termination charge, applicable to all types of traffic, would permit and encourage all carriers to compete on an equal basis, allowing the competitive marketplace, and not regulatory fiat, to determine the ultimate market outcome.

28. The most direct and efficient way to put an end to gaming of the system and to encourage competition and innovation across the industry is to adopt a comprehensive *cost-based rate* for intercarrier compensation. However, the short window that the Commission has between now and November 5 is not sufficient to complete this task in a thorough and considered manner. The Commission has been directed to address the specific issue of its discriminatory treatment of ISP-bound traffic. Whatever the legal and policy justifications motivated the Commission's adoption of the interim rules in 2001, those justifications have either been discredited or superseded by industry developments. The time has come for the Commission to end the interim regime and restore uniform reciprocal compensation rates, pending the completion of its comprehensive Unified Intercarrier Compensation docket.

29. Preserving – and where cost-justified, expanding – the alternative of dial-up Internet access depends on providers being fairly compensated for the costs associated with handling this traffic. The cost-based (TELRIC) rates for reciprocal compensation achieve this result; neither the rate adopted in the interim rules nor the even more extreme "bill-and-keep" approach do. As explained above, in the seven years since the Commission implemented rules that capped the

rates for this traffic at rates well below those for other Section 251(b)(5) traffic, dial-up Internet traffic has declined substantially, as many customers have migrated to broadband services. In light of this change, the revenue impact of equalizing rates on a going-forward basis (a logical realignment in light of the Commission's overall intercarrier compensation goals) cannot possibly be deemed to create a burden. Equally if not more importantly, the alternative of dial-up Internet access continues to serve an important role in meeting the needs of certain segments of the population, including low-income and rural customers.

V. AT&T's *Waiver Petition* is an opportunistic appeal for the Commission to shortchange other participants in the *Unified Intercarrier Compensation Reform* and *IP-Enabled Services* dockets

30. While there is nearly universal agreement that the goal of unifying intercarrier compensation at a single, rational rate is long overdue, there is nothing to be gained by adopting new, stop-gap measures at the present time and certainly no basis for adopting them on the sort of emergency basis being urged by AT&T.[25] Indeed, the changes that AT&T has put forward in its Petition are nothing but a ploy to have its own parochial interests addressed at the expense of other carriers and at great risk to the Commission's desired goal of reaching a unified intercarrier compensation regime.

25. *Petition of AT&T Inc. for Interim Declaratory Ruling and Limited Waivers*, WC Docket 08-152, July 17, 2008. The Commission has also received some *ex parte* proposals for expedited resolution of the open proceedings on intercarrier compensation reform – or selected segments of those proceedings – such as the August 6, 2008 letter, submitted in WC Docket 04-36 and CC Docket 01-92, by a coalition of ILECs, CMRS providers, and others (hereinafter "ILEC/CMRS coalition").

31. The only legitimately pressing obligation facing the Commission is to respond to the mandate of the D.C. Circuit Court of Appeals to act on the 2002 remand of the Commission's interim rules concerning ISP-bound traffic.[26] Responding to the Court's directive, by the November 5, 2008 deadline is not a trivial undertaking. If there was a simple, completely noncontroversial response, the Commission would likely have completed this task several years ago.

32. The Commission's goal – reiterated frequently over the past decade – can only be made more difficult to achieve by attempting to justify a separate and unequal compensation mechanism for ISP-bound traffic or by implementing any of the "interim" exceptions being proposed by AT&T. Back in 2001, when the Commission implemented the "interim" ISP rules just as it was announcing its intention to "unify" intercarrier compensation, the Commission rationalized its action on the basis that steps in "the right direction, even if incomplete" should not have to await "a perfect ultimate solution."[27] However, the disparate treatment afforded ISP-bound calls under the *ISP Remand Order* has not turned out to have been a step in the right direction, and the "fixes" that AT&T is now asking the Commission to adopt on an interim basis are actually steps in the *wrong* direction. The time for patching the intercarrier compensation regime has long past. Today, further "interim" fixes only add to the eventual complexity of what

26. *WorldCom, Inc. v. FCC*, 288 F.3d 429 (D.C. Cir. 2002)

27. *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, CC Docket No. 96-98; CC Docket No. 99-68, *Order on Remand and Report and Order*, 16 FCC Rcd 9151, 9197 (2001)("*ISP Remand Order"*).

the Commission must face in order to actually define and implement a unified, cost-based intercarrier compensation framework.

AT&T's proposals are self-serving and factually questionable

33. A central theme underlying AT&T's most recent attempt to divert the intercarrier compensation reform process to its own parochial interests involves its claim that there is an urgent need to impose access charges on certain VoIP calls, because of the presence of purported disparities in the application of intercarrier charges based upon the type of traffic and the types of carriers involved. There is nothing unique in AT&T's observation that the intercarrier compensation system requires rationalizing – this, of course, is the premise of the Commission's seven year old *Unified Intercarrier Compensation* rulemaking. However, what separates AT&T's objective from what should be the Commission's is AT&T's desire to "fix" only those portions of the intercarrier compensation regime that it perceives as disadvantageous to itself, while leaving whatever beneficial inequalities may exist in place. In arguing that VoIP calls should immediately become subject to access charges (something that the Commission has thus far declined to require), AT&T seeks to "unify" future intercarrier compensation rules not at cost-based levels, but instead around the existing access charge regime, under which rates are seriously misaligned with costs and under which there is no useful precedent for intercarrier compensation involving two local exchange carriers.

34. As AT&T seeks to portray it, when "over-the-top" VoIP[28] providers hand off calls to an ILEC for termination to the called party, they represent the call as local, §251(b)(5) traffic and pay reciprocal compensation rates, rather than switched access charges, to the terminating ILEC. AT&T claims that this disparity vis-a-vis traditional LECs and IXCs benefits VoIP providers by enabling them to hand off interexchange traffic to ILECs without paying access charges, while disadvantaging AT&T and other incumbent carriers both by depriving them of access charge revenue to which they are entitled and placing them at a competitive disadvantage to the extent that services that compete with those offered by entrants are subject to full access charge treatment. What AT&T has neglected to point out, however, is that such disparities in existing intercarrier compensation arrangements actually cut both ways, and that AT&T and its predecessor RBOCs have, in fact, reaped enormous financial and competitive gains from their existence. Indeed, these gains have almost certainly dwarfed those alleged (by AT&T) to have been realized by CLECs.

35. The single greatest beneficiaries of existing disparities in the application of switched access charges have been CMRS carriers and, in particular, those affiliated with RBOCs such as AT&T and Verizon.[29] This is because the FCC has expressly exempted most intrastate long

---

28. An "over-the-top" VoIP provider is one that does not also own and/or control the last mile facility between the customer's home and the provider's network. Thus, in order to use an "over-the-top" VoIP service, the customer is required to obtain the requisite broadband transmission from another provider.

29. It is also not surprising that, in the recent ILEC/CMRS coalition proposal, AT&T and Verizon have been joined by the wireless industry, since the prevailing proposals for revenue neutrality ("make whole") involve increases in rates (including originating switched access

distance calls and many interstate long distance calls placed from wireless phones from access charges, permitting the carrier to treat such calls as §251(b)(5) "local" traffic when handing them off to a LEC for termination. To put the effect of this CMRS access charge exemption in its proper context, the Cellular Telecommunications and Internet Association ("CTIA"), the wireless industry trade group, estimates that there are more than 262.5-million wireless phones in use in the US.[30] By contrast, all of the nomadic or "over-the-top" VoIP providers *combined* serve in the range of 3- to 4-million customers nationwide.[31] Aggregate US wireless industry revenues amount to more than $140-billion annually, roughly 100 times the $1.4-billion or so in annual revenues being reported by the principal "over-the-top" VoIP service providers.[32] The enormous and unique advantages that the AT&T and Verizon derive from this advantageous treatment[33] stems from the FCC classification of wireless-originated calls placed between points within the same Major Trading Area ("MTA") as "local" and therefore subject to reciprocal

---

charges and SLCs) that wireless carriers do not pay.

30. http://www.ctia.org/ (accessed 7/30/08).

31. Vonage, 8x8 2007 10-K Annual Reports.

32. *Id.* See also, http://www.ctia.org/ (accessed 7/30/08).

33. As the FCC notes in its *12th Annual Report and Analysis of Competitive Market Conditions With Respect to Commercial Mobile Services (CMRS Report*), "a number of analysts have argued thatwireless service is competitive or cheaper than wireline, particularly if one is making a long-distance call or when traveling. As one analyst wrote, "At currently effective yields, we continue to believe wireless pricing is competitive with traditional wireline pricing. Lower yields, combined with the convenience of mobility, should continue to drive wireline displacement."" Para. 249, footnotes omitted.

compensation rather than access charges when terminated to a wireline LEC. The details of this special treatment for wireless calls is discussed in Attachment 2 to these comments.

36. AT&T makes no mention of this enormous competitive advantage in its *Petition*, but instead argues that VoIP competitors – with minuscule long distance market shares in comparison with the RBOCs' wireless affiliates – should be subject to access charges on all interexchange calls, placing such companies at an enormous competitive disadvantage relative to CMRS carriers.[34] There is no legal or policy basis on which the Commission could properly eliminate the purported disparity between VoIP and traditional circuit-switched long distance service providers with respect to access charges while leaving unaddressed the far larger disparity between the charges that apply for terminating intraMTA wireless vs. wireline calls.[35]

---

34. 37.56% of AT&T profits in 2007 came from its wireless business. Nationally, wireless long distance usage is growing at 17% annually, while wireline LD has been in a steep decline since its peak in 2000. (FCC *Trends in Telephone Service* report, February 2007, Tables 10.2, 11.4; *CTIA Semi-Annual Wireless Industry Survey, Data ending December 2007*, "Reported Wireless Minutes of Use Exceed two trillion in 2007.") When AT&T and other ILECs "lose" long distance business to their own wireless affiliate as a result of the latter's significantly lower access costs, the net effect is merely to shift revenues and profits from one pocket to another. CLECs who do not enjoy the same access charge treatment as wireless carriers, on the other hand, are not so fortunate.

35. Although AT&T makes no mention of the special treatment being afforded its wireless affiliate with respect to access charges, the Company has certainly been well aware of the competitive consequences of this disparity for some time. For example, in an October 2, 2003 petition filed with the New Jersey Board of Public Utilities at a point in time when AT&T had no wireless affiliate, the Company advised the BPU that

> As a consequence of these large MTAs, and the applicable FCC rules, wireless carriers enjoy a substantial and entirely artificial cost advantage over IXCs, because, unlike IXCs, the CMRS providers pay no access charges on the vast majority of the intrastate calls that their subscribers

The Commission should not eliminate an intercarrier compensation treatment that benefits those entrepreneurial firms that have pioneered in the development and dissemination of VoIP technology nationwide without also addressing other aspects of existing intercarrier compensation rules under which massive financial and competitive benefits inure to the largest incumbent carriers.

AT&T's "interim" proposal presupposes the adoption of the *Missoula Plan* or a similar "make whole" approach to intercarrier compensation reform

37. It is also extremely troubling that AT&T's proposed solutions, while characterized as "interim" in nature, would not have a merely neutral effect upon the Commission's subsequent deliberations concerning unified intercarrier compensation rates. Among other things, AT&T's proposal would result in additional traffic being subject to admittedly above-cost access charges and would put in place some of the highly troubling "make-whole" provisions from the AT&T-

---

> place within the State. Under the FCC rules, calls that wireless providers complete within each of these MTAs are treated as "local" traffic, regardless of the distance of the call, and thus are subject, not to access charges, but to reciprocal compensation. Thus, a call from a VNJ affiliates' wireless customer located in Atlantic City to a VNJ wire-line customer in Trenton – an interLATA call – would result in charges to VNJ's wireless affiliate of as little as $0.0007 per minute, under the assumption that VNJ elected to apply the reciprocal compensation rates prescribed in the FCC's ISP Remand Order. By contrast, an interexchange carrier carrying a call from a VNJ wire-line customer in Atlantic City to the same VNJ customer in Trenton would be required to pay VNJ's access charges, at per conversation minute rates of nearly 4 cents.

Petition of AT&T Communications of NJ, L.P. to the State of New Jersey, Board of Public Utilities, October 2, 2003, at at para. 13, footnotes omitted.

endorsed *Missoula Plan*. In November of 2006, a group of CLECs including Pac-West[36] asked ETI to analyze the *Missoula Plan* and the purported economic benefits – some $54-billion in economywide gains – being claimed for it by its proponents. ETI's report, *The True Economic Impact of the "Missoula Plan" for Intercarrier Compensation,"* was submitted to the Commission in November 2006. A copy of that report is annexed hereto as Attachment 3.

38. ETI showed that the *Missoula* sponsors' claim of economic gain was based upon six fatally flawed assumptions, and that when these were replaced by the correct assumptions and data, the economywide impact of the *Missoula Plan* would be decidedly negative, resulting in *economic losses* of as much as $39- to $44-billion. (See *ETI Report*, at Table 9):

- Assumption 1. *Missoula* proponents assume that 100% of access charge reductions would be flowed through to consumers in the form of lower prices. Given the current status of competition in the long distance market, this seems highly unlikely. Moreover, at any flow-through level below 54%, all else equal, *Missoula* results in negative economic gains (i.e., losses) economy-wide. (See *ETI Report*, at Table 4).

- Assumption 2. The purported benefits calculated by supporters of *Missoula* assume that 100% of voluntary intrastate reductions are adopted immediately. 72% of the plan's reductions are intrastate, and many of those are voluntary, so any delay (or failure) in implementation directly impacts the potential consumer benefits. (See *ETI Report* at Table 5 and discussion at page 13).

- Assumptions 3-4. The proponents' study relies upon outdated and unrealistic measures of price-elasticities of demand. The elasticity of demand used for toll services (-0.72) was developed by the FCC in its *Second Report and Order* in CC Docket 87-313 adopting the original ILEC price cap plan, and was based upon price and demand data

36. The other participants were: Alltel Communications, Inc., Cavalier Telephone, McLeodUSA, National Cable & Telecommunications Association, NuVox, Inc., RCN Telecom Services, Inc., and XO Communications, LLC.

dating from 1984.[37] During that time, prices for toll service ranged from $0.50 to $1.00 per minute, whereas long distance prices in effect today range from a few cents per minute to "free" – i.e., bundled with other wireline and wireless services. Elasticities are valid for only a small range of prices. The price elasticity of demand used in a model for wireless services suffers similar infirmities. (See *ETI Report* at Tables 6 and 7, and discussion at pages 16-17).

- Assumption 5. The proponents' "benefits" analysis assumed that all minutes are purchased on a per-minute basis, ignoring block of time and unlimited usage plans. If consumers purchase minutes in buckets, decreases in per-minute pricing will not stimulate any additional demand. All else equal, if per minute pricing applied to anything less than 52% of minutes, *Missoula* would produce net economic harm. (See *ETI Report at* Table 8).

- Assumption 6. Proponents incorrectly use a regional economic multiplier rather than considering the net economywide effects of their unsupported claim that the plan would result in $4.97-billion in increased telecom spending. This ignores both the macroeconomic effects of decreased spending in other segments of the economy, as well as the negative effects that might arise from potential rate increases applicable to business customers, which would suppress their demand for other services. (See *ETI Report* at 22.)

If *Missoula* were adopted and, *arguendo*, all of the above assumptions turned out to be true, the supposedly "revenue-neutral" Plan would result in massive windfall gains for ILECs in the form of $8.5-billion in increased access revenues and $29.1-billion in increased toll revenues. If the Plan's beneficiaries do not pass through access savings to consumers – and neither the *Plan* nor competitive marketplace forces would compel them to do so – ILEC parent corporations would receive an additional $28.7-billion over 8 years. (See *ETI Report* at pages 6-7).

37. *In the Matter of Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, 5 FCC Rcd 6786(1990) at para. 83-84 and Appendix C.

39. Unlike the AT&T Petition and *Missoula Plan*, the recent ILEC/CMRS coalition Proposal confines the matter of revenue neutrality to a single, passing reference.[38] However, the Commission should not believe that revenue recoupment is ever a back-burner issue for the incumbents. If the ILEC members of the ILEC/CMRS coalition were told that the Commission was prepared to adopt an across-the-board intercarrier compensation rate of $0.0007 – with no opportunity for revenue neutral adjustments in other charges (such as SLCs, universal service, or originating access charges) – they would undoubtedly bolt immediately from the coalition.

VI. The Commission should not depart from its commitment to establish a unified cost-based intercarrier compensation regime

40. Any significant misalignment of rate with cost will create incentives to change how traffic is routed.[39] Many such alignments are considered to exist[40] within the present, fractured intercarrier compensation regime. Any carrier can point out the particular areas that they perceive to cause them to experience revenue loss, increased costs, or some other form of

---

38. ILEC/CMRS Proposal at 2 ("this transition [to uniform compensation rules] should allow for appropriate alternative recovery mechanisms, if needed.")

39. Conversely, while some changes in how traffic is handled are based on cost misalignments, this is not always the case – for example, a new technology may in fact result in a lower-cost way of handling traffic. Thus, VoIP may well be cheaper than circuit-switched technology for handling the interexchange portion of a voice call, even if (arguendo) it costs the same to originate/terminate calls when using the PSTN. An efficient compensation regime should not prevent people from coming up with more efficient telecommunications technologies simply to preserve the cost levels/structure of those that invested in earlier technologies.

40. Although the Commission has speculated that CLECs were selectively seeking out IP customers to take advantage of a misalignment between the cost of handling IP-bound traffic and the reciprocal compensation rate, the Commission has never specifically analyzed these costs.

competitive disadvantage. However, fixing the problems based on anecdotal evidence and without regard to solid cost information would be a monumental mistake. Cost, not the perceived behavior of the industry in response to cost signals, must be the basis for these distinctions. What the Commission cannot do (legally) and should not do (if it intends to promote economically efficient behavior) is to speculate about the costs associated with various forms of intercarrier compensation and to set rates accordingly.

41. Just as rates set too high may lead to uneconomic responses, so may rates that are set too low. The solution to a pendulum that has swung too far to the above-cost side is not to push it too far to the below-cost side. In the same way that the initially above-cost call termination rate may have induced CLECs to seek out customers with disproportionately high inward calling volumes, if a below-cost (or zero-priced bill-and-keep) call termination charge is adopted for all traffic, carriers will have an incentive to seek out customers with disproportionately high outbound calling, such as telemarketing call centers. The only correct solution is to adopt a uniform call termination charge, applicable to all traffic, that is based upon TELRIC. As summarized in Table 1 below, numerous state PUCs have examined and adopted TELRIC-based call termination rates, which are almost uniformly well in excess of the $0.0007 cap being proposed by the ILEC/CMRS coalition.

Table 1

ILEC Cost-Based Reciprocal Compensation Rates
vs. ISP-bound Reciprocal Compensation Rate of $0.0007

State	ILEC	Rate Per MOU	% Higher than ISP rate (assumes 20 minute call length)
AZ	Qwest	$0.0015200	217%
CA	at&t	$0.0030830	455%
CA	Verizon	$0.0019280	275%
CO	Qwest	$0.0026590	380%
NV	Embarq	$0.0039930	570%
NV	Verizon	$0.0101419	1449%
NV	at&t	$0.0040320	617%
OR	Qwest	$0.0036700	524%
OR	Verizon	$0.0036700	524%
UT	Qwest	$0.0026060	372%
WA	Qwest	$0.0026280	375%
WA	Verizon	$0.0070160	1002%

Source: Pac-West ex parte letter, CC Docket No. 99-68, CC Docket No. 01-92, filed August 18, 2008.

42. With respect to AT&T's apparent confusion about whether to "raise the bridge" (via its Petition to impose access charges on VoIP traffic) or "lower the water" (via the ILEC/CMRS coalition proposal to lower VoIP and other interexchange termination down to $0.0007), it must be realized that while uniformity is the goal, how it is achieved is not merely a matter of convenience – it must be cost-based.

VII. Conclusion: The Commission should narrowly respond to the *Core Comm* mandate and reject stop-gap, piecemeal solutions that fail to advance the goal of comprehensive intercarrier compensation reform

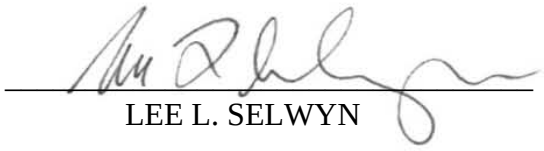
43. Whether the flaws in the intercarrier compensation system of which AT&T complains in its July 17 filings are real or imagined, there is no showing that they are so unique or pressing that they require "fixing" outside the comprehensive framework envisioned by the Commission. Moreover, whether the purported misalignments of which AT&T complains are more or less harmful (to the industry as a whole) than other misalignments that are not of concern to AT&T is not clear. This is precisely why the Commission committed to comprehensive reform.

44. In any event, the matters that AT&T asks to Commission to push to the head of the queue are hardly issues of which the Commission is unaware. They are identified and analyzed in various NPRMs that the Commission has issued over the past seven years, including but not limited to the original and further NPRMs in the *Unified Intercarrier Compensation* proceeding and, more recently, the *IP-Enabled Services* rulemaking.[41] None of these issues is made more – or less – pressing by the issuance of the *Core Comm* Mandate. In order to move forward with a targeted and expeditious response to the Court and to maintain its long-proclaimed intention to arrive at a rational, comprehensive, and unified intercarrier compensation regime, the Commission should reject in full AT&T's Petition for Interim Declaratory Ruling and Unlimited Waivers (along with any other stop-gap proposals that have been filed on an *ex parte* basis).

41. *In the Matter of IP-Enabled Services*, WC Docket No. 04-36, *Notice of Proposed Rulemaking*, 19 FCC Rcd 4863 (2004).

VERIFICATION

The foregoing statements are true and correct to the best of my knowledge, information and belief, and if called to testify thereon I am prepared to do so.



LEE L. SELWYN

Attachment 1

STATEMENT OF QUALIFICATIONS

Lee L. Selwyn

ECONOMICS AND TECHNOLOGY, INC.

Attachment 1

Statement of Qualifications

LEE L. SELWYN

Dr. Lee L. Selwyn has been actively involved in the telecommunications field for more than forty years, and is an internationally recognized authority on telecommunications regulation, economics and public policy. Dr. Selwyn founded the firm of Economics and Technology, Inc. in 1972, and has served as its President since that date. He received his Ph.D. degree from the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. He also holds a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with honors in Economics from Queens College of the City University of New York.

Dr. Selwyn has testified as an expert on rate design, service cost analysis, form of regulation, and other telecommunications policy issues in telecommunications regulatory proceedings before some forty state commissions, the Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission, among others. He has appeared as a witness on behalf of commercial organizations, non-profit institutions, as well as local, state and federal government authorities responsible for telecommunications regulation and consumer advocacy.

He has served or is now serving as a consultant to numerous state utilities commissions including those in Arizona, Minnesota, Kansas, Kentucky, the District of Columbia, Connecticut, California, Delaware, Maine, Massachusetts, New Hampshire, Vermont, New Mexico, Wisconsin and Washington State, the Office of Telecommunications Policy (Executive Office of the President), the National Telecommunications and Information Administration, the Federal Communications Commission, the Canadian Radio-television and Telecommunications Commission, the United Kingdom Office of Telecommunications, and the Secretaria de Comunicaciones y Transportes of the Republic of Mexico. He has also served as an advisor on telecommunications regulatory matters to the International Communications Association and the Ad Hoc Telecommunications Users Committee, as well as to a number of major corporate telecommunications users, information services providers, paging and cellular carriers, and specialized access services carriers.

Dr. Selwyn has presented testimony as an invited witness before the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance and before the U.S. Senate Judiciary Committee, on subjects dealing with restructuring and deregulation of portions of the telecommunications industry.

In 1970, he was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time sharing industry. This work was conducted at Harvard University's Program on Technology and Society, where he was appointed as a Research Associate. Dr. Selwyn was also a member of the faculty at the College of Business Administration at Boston University from 1968 until 1973, where he taught courses in

economics, finance and management information systems.

Dr. Selwyn has been an invited speaker at numerous seminars and conferences on telecommunications regulation and policy, including meetings and workshops sponsored by the National Telecommunications and Information Administration, the National Association of Regulatory Utility Commissioners, the U.S. General Services Administration, the Institute of Public Utilities at Michigan State University, the National Regulatory Research Institute at Ohio State University, the Harvard University Program on Information Resources Policy, the Columbia University Institute for Tele-Information, the International Communications Association, the Tele-Communications Association, the Western Conference of Public Service Commissioners, at the New England, Mid-America, Southern and Western regional PUC/PSC conferences, as well as at numerous conferences and workshops sponsored by individual regulatory agencies.

Papers and Publications

"Taxes, Corporate Financial Policy and Return to Investors," *National Tax Journal*, Vol. XX, No.4, December 1967.

"Considerations for Computer Utility Pricing Policies" (with Daniel S. Diamond), presented at the 23rd Association for Computing Machinery National Conference, 1968.

"Real Time Computer Communications and the Public Interest " (with Michael M. Gold), presented at the 1968 American Federation of Information Processing Societies, Fall Joint Computer Conference, San Francisco, CA, December 9-11, 1968.

"Computer Resource Accounting in a Time Sharing Environment," presented at the 1970 American Federation of Information Processing Societies, Spring Joint Computer Conference, Atlantic City, NJ, May 5-7, 1970.

Planning Community Information Utilities, H. Sackman and B. W. Boehm, Eds., Chapter 6, "Industrial and Vocational Services," Montvale, NJ, AFIPS Press, 1972, at 137-172.

"Competition and Structure in the Computer Services Industry," *Proceedings, Second Annual Symposium on Economic Considerations in Managing the Computer Installation*, New York: Association for Computing Machinery, 1972.

"Computer Resource Accounting and Pricing," *Proceedings, Second Annual Symposium on Economic Considerations in Managing the Computer Installation*, New York: Association for Computing Machinery, 1972.

"Pricing Telephone Terminal Equipment Under Competition," *Public Utilities Fortnightly*, December 8, 1977.

"Deregulation, Competition, and Regulatory Responsibility in the Telecommunications Industry," *Presented at the 1979 Rate Symposium on Problems of Regulated Industries - Sponsored by: The American University, Foster Associates, Inc., Missouri Public Service Commission, University of Missouri-Columbia*, Kansas City, MO, February 11 - 14, 1979.

"Sifting Out the Economic Costs of Terminal Equipment Services," *Telephone Engineer and Management*, October 15, 1979.

"Usage-Sensitive Pricing" (with G. F. Borton), (a three part series), *Telephony*, January 7, 28, February 11, 1980.

"Perspectives on Usage-Sensitive Pricing," *Public Utilities Fortnightly*, May 7, 1981.

"Diversification, Deregulation, and Increased Uncertainty in the Public Utility Industries" *Comments Presented at the Thirteenth Annual Conference of the Institute of Public Utilities*, Williamsburg, VA - December 14-16, 1981.

"Local Telephone Pricing: Is There a Better Way?; The Costs of LMS Exceed its Benefits: a Report on Recent U.S. Experience," *Proceedings of a conference held at Montreal, Quebec - Sponsored by Canadian Radio-Television and Telecommunications Commission and The Centre for the Study of Regulated Industries, McGill University*, May 2-4, 1984.

"Long-Run Regulation of AT&T: A Key Element of A Competitive Telecommunications Policy," *Telematics*, August 1984.

"Is Equal Access an Adequate Justification for Removing Restrictions on BOC Diversification?" *Presented at the Institute of Public Utilities Eighteenth Annual Conference*, Williamsburg, VA - December 8-10, 1986.

"Market Power and Competition Under an Equal Access Environment," *Presented at the Sixteenth Annual Conference, "Impact of Deregulation and Market Forces on Public Utilities: The Future Role of Regulation," Institute of Public Utilities, Michigan State University*, Williamsburg, VA - December 3-5, 1987.

"Contestable Markets: Theory vs. Fact," *Presented at the Conference on Current Issues in Telephone Regulations: Dominance and Cost Allocation in Interexchange Markets - Center for Legal and Regulatory Studies Department of Management Science and Information Systems - Graduate School of Business, University of Texas at Austin*, October 5, 1987.

"The Sources and Exercise of Market Power in the Market for Interexchange Telecommunications Services," *Presented at the Nineteenth Annual Conference, "Alternatives to Traditional Regulation: Options for Reform," Institute of Public Utilities, Michigan State University*, Williamsburg, VA, December, 1987.

"Assessing Market Power and Competition in The Telecommunications Industry: Toward an Empirical Foundation for Regulatory Reform," *Federal Communications Law Journal*, Vol. 40 Num. 2, April 1988.

"A Perspective on Price Caps as a Substitute for Traditional Revenue Requirements Regulation," *Presented at the Twentieth Annual Conference, "New Regulatory Concepts, Issues and Controversies," Institute of Public Utilities, Michigan State University*, Williamsburg, VA, December, 1988.

"The Sustainability of Competition in Light of New Technologies" (with D. N. Townsend and P. D. Kravtin), *Presented at the Twentieth Annual Conference, Institute of Public Utilities, Michigan State University*, Williamsburg, VA, December, 1988.

"Adapting Telecom Regulation to Industry Change: Promoting Development Without Compromising Ratepayer Protection" (with S. C. Lundquist), *IEEE Communications Magazine*, January, 1989.

"The Role of Cost Based Pricing of Telecommunications Services in the Age of Technology and Competition," *Presented at National Regulatory Research Institute Conference*, Seattle, July 20, 1990.

"A Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network" (with Patricia D. Kravtin and Paul S. Keller), Columbus, Ohio: *National Regulatory Research Institute*, September 1991.

"Telecommunications Regulation and Infrastructure Development: Alternative Models for the Public/Private Partnership," *Prepared for the Economic Symposium of the International Telecommunications Union Europe Telecom '92 Conference, Budapest, Hungary*, October 15, 1992.

"Efficient Infrastructure Development and the Local Telephone Company's Role in Competitive Industry Environment" Presented at the *Twenty-Fourth Annual Conference, Institute of Public Utilities, Graduate School of Business, Michigan State University, "Shifting Boundaries between Regulation and Competition in Telecommunications and Energy,"* Williamsburg, VA, December 1992.

"Measurement of Telecommunications Productivity: Methods, Applications and Limitations" (with Françoise M. Clottes), *Presented at Organisation for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, `93 Conference "Defining Performance Indicators for Competitive Telecommunications Markets," Paris, France,* February 8-9, 1993.

"Telecommunications Investment and Economic Development: Achieving efficiency and balance among competing public policy and stakeholder interests," *Presented at the 105th Annual Convention and Regulatory Symposium, National Association of Regulatory Utility Commissioners, New York,* November 18, 1993.

"The Potential for Competition in the Market for Local Telephone Services" (with David N. Townsend and Paul S. Keller), *Presented at the Organization for Economic Cooperation and Development Workshop on Telecommunication Infrastructure Competition*, December 6-7, 1993.

"Market Failure in Open Telecommunications Networks: Defining the new natural monopoly," *Utilities Policy,* Vol. 4, No. 1, January 1994.

The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, (with Susan M. Gately, et al) a report prepared by Economics and Technology, Inc. and Hatfield Associates, Inc. for AT&T, MCI and CompTel, February 1994.

Commercially Feasible Resale of Local Telecommunications Services: An Essential Step in the Transition to Effective Local Competition, (Susan M. Gately, et al) a report prepared by Economics and Technology, Inc. for AT&T, July 1995.

"Efficient Public Investment in Telecommunications Infrastructure," *Land Economics*, Vol 71, No.3, August 1995.

Funding Universal Service: Maximizing Penetration and Efficiency in a Competitive Local Service Environment (with Susan M. Baldwin, under the direction of Donald Shepheard), A Time Warner Communications Policy White Paper, September 1995.

Stranded Investment and the New Regulatory Bargain (with Susan M. Baldwin, under the direction of Donald Shepheard), A Time Warner Communications Policy White Paper, September 1995

"Market Failure in Open Telecommunications Networks: Defining the new natural monopoly," in *Networks, Infrastructure, and the New Task for Regulation*, by Werner Sichel and Donal L. Alexander, eds., University of Michigan Press, 1996.

Establishing Effective Local Exchange Competition: A Recommended Approach Based Upon an Analysis of the United States Experience, paper prepared for the Canadian Cable Television Association and filed as evidence in Telecom Public Notice CRTC 95-96, Local Interconnection and Network Component, January 26, 1996.

Adapting Taxation Policies to a Changing Telecommunications Industry, presented at the Public Utilities Seminar, International Association of Assessing Officers, Louisville, KY, March 22, 1996.

The Cost of Universal Service, A Critical Assessment of the Benchmark Cost Model, (with Susan M. Baldwin), a report prepared by Economics and Technology, Inc. on behalf of the National Cable Television Association and submitted with Comments in FCC Docket No. CC-96-45, April 1996.

Economic Considerations in the Evaluation of Alternative Digital Television Proposals, paper prepared for the Computer Industry Coalition on Advanced Television Service, filed with comments in FCC MM Docket No. 87-268, In the Matter of Advanced Television Systems and Their Impact Upon the Existing Television Broadcast Service, July 11, 1996.

Assessing Incumbent LEC Claims to Special Revenue Recovery Mechanisms: Revenue opportunities, market assessments, and further empirical analysis of the "Gap" between embedded and forward-looking costs, (with Patricia D. Kravtin), filed in *Access Charge Reform*, CC Docket No. 96-262, January 29, 1997.

The Use of Forward-Looking Economic Cost Proxy Models (with Susan M. Baldwin), Economics and Technology, Inc., February 1997.

The Effect of Internet Use On The Nation's Telephone Network (with Joseph W. Laszlo), report prepared for the Internet Access Coalition, July 22, 1997.

Regulatory Treatment of ILEC Operations Support Systems Costs, Economics and Technology, Inc., September 1997.

The "Connecticut Experience" with Telecommunications Competition: A Case Study in Getting it Wrong (with Helen E. Golding and Susan M. Gately), Economics and Technology, Inc., February 1998.

Where Have All The Numbers Gone? Long-term Area Code Relief Policies and the Need for Short-term Reform, prepared by Economics and Technology, Inc. for the Ad Hoc Telecommunications Users Committee, International Communications Association, March 1998, second edition, June 2000.

Broken Promises: A Review of Bell Atlantic-Pennsylvania's Performance Under Chapter 30 (with Sonia N. Jorge and Patricia D. Kravtin), Economics and Technology, Inc., June 1998.

Building A Broadband America: The Competitive Keys to the Future of the Internet (with Patricia D. Kravtin and Scott A. Coleman), report prepared for the Competitive Broadband Coalition, May 1999.

Bringing Broadband to Rural America: Investment and Innovation In the Wake of the Telecom Act (with Scott C. Lundquist and Scott A. Coleman), report prepared for the Competitive Broadband Coalition, September 1999.

Bringing Local Telephone Competition to Massachusetts (with Helen E. Golding), prepared for The Massachusetts Coalition for Competitive Phone Service, January 2000.

Subsidizing the Bell Monopolies: How Government Welfare Programs are Undermining Telecommunications Competition, Economics and Technology, Inc., April 2002.

Competition in Access Markets: Reality or Illusion, A Proposal for Regulating Uncertain Markets (with Susan M. Gately and Helen E. Golding), Economics and Technology, Inc., prepared for the Ad Hoc Telecommunications Users Committee, August 2004.

"When the Competition Died – and What We Can Learn From the Autopsy, " presented at the 37th Annual Regulatory Policy Conference, Institute of Public Utilities, Michigan State University, Richmond, Virginia, December 5, 2005.

Avoiding the Missteps made South of the Border: Learning from the US Experience in Competitive Telecom Policy (with Helen E. Golding), Economics and Technology, Inc., prepared on behalf of MTS Allstream, Inc., August 16, 2006.

Attachment 2

THE CMRS ACCESS CHARGE EXEMPTION

ECONOMICS AND
TECHNOLOGY, INC.

Attachment 2

THE CMRS ACCESS CHARGE EXEMPTION

Wireless carriers pay no originating access charges and are exempt from the requirement to pay access charges on most intrastate and on many interstate long distance calls

Unlike interexchange carriers that are required to make access charge payments to ILECs at both the originating and terminating ends of each long distance call handled by the IXC, wireless carriers pay no access charges whatsoever at the originating end of such calls (because they are placed over the wireless carrier's own network), and have been expressly exempted by the FCC from payment of access charges at the terminating end of any long distance call to a point that is within the same "Major Trading Area" (MTA) as the call originator. Intra-MTA calls are considered by the FCC to be local, §251(b)(5) traffic, even though the very same call would be considered as "toll" and subject to access charges if placed from a wireline phone. For such intra-MTA calls, the CMRS carrier is required to pay the terminating ILEC only the local reciprocal compensation rate rather than the intrastate or interstate switched access rate that wireline carriers are required to pay, and that AT&T is asking be imposed upon VoIP calls as well. Wireless carriers' ability to offer their subscribers what amounts to "free" long distance calling stems not from any inherent efficiency or lower cost vis-a-vis wireline IXCs, but instead from the fact that wireless carriers do not pay anything close to the same level of access charges as do IXCs for what are in all other material respects entirely comparable long distance calls.

IXCs are required, pursuant to Part 69 of the FCC's Rules,[1] to pay access charges to local exchange carriers for the origination and termination of interexchange calls carried by the IXC.[2] "Interexchange" calls are defined for this purpose as calls between exchanges not within the same local calling area. Local calling areas are ordinarily established in ILEC (or CLEC) tariffs and are subject to approval by the state public utility commission. However, in the case of *wireless* carriers, the FCC has *preempted* the state commissions with respect to the definition and scope of *wireless* local calling areas:

> ... in light of this Commission's exclusive authority to define the authorized license areas of wireless carriers, we will define the local service area for calls to or from a CMRS network for the purposes of applying reciprocal compensation obligations under section

1. 47 CFR §69.105

2. To be more precise, IXCs are required to pay access charges on *all* calls handed off to them, even if the two endpoints of the call are physically located within the same ILEC local calling area.

> 251(b)(5). Different types of wireless carriers have different FCC-authorized licensed territories, the largest of which is the "Major Trading Area" (MTA). *Because wireless licensed territories are federally authorized, and vary in size, we conclude that the largest FCC-authorized wireless license territory (i.e., MTA) serves as the most appropriate definition for local service area for CMRS traffic for purposes of reciprocal compensation under section 251(b)(5) as it avoids creating artificial distinctions between CMRS providers.* Accordingly, traffic to or from a CMRS network that originates and terminates within the same MTA is subject to transport and termination rates under section 251(b)(5), rather than interstate and intrastate access charges.[3]

Here the FCC not only exempts wireless intra-MTA calling from access charges, it expressly preempts and supersedes wireline local calling area definitions as adopted or approved by state commissions and, indeed, goes so far as to adopt as "the most appropriate definition for local service area for CMRS traffic" "the largest FCC-authorized wireless license territory (i.e., MTA)" specifically so as to "avoid[] creating artificial distinctions between CMRS providers" having licensed service area footprints of differing sizes. The basis for the FCC's preemption of state-defined local calling areas for wireless carriers is expressly stated as "this Commission's exclusive authority to define the authorized license areas of wireless carriers." In its effort to avoid "creating artificial distinctions between CMRS providers," the FCC has instead institutionalized a massive and – as has become painfully apparent – competitively fatal distinctions between wireline and wireless carriers, placing the former at so severe a competitive disadvantage that the two largest wireline IXCs – AT&T and MCI – felt compelled to "throw in the towel" and abandon the "stand-alone long distance" business altogether. It is patently unfair for IXCs to be placed at so large a competitive disadvantage vis-a-vis wireless carriers merely because IXCs are forced to pay access charges for many calls for which CMRS carriers are not.[4]

---

3. Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98; Interconnection Between Local Exchange Carriers and Commercial Radio Service Providers, CC Docket 95-185; *First Report and Order*, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*"), 16014, at para. 1036, footnotes omitted, emphasis supplied.

4. Even where a CMRS-originated call terminates to a wireline customer outside of the MTA of the calling party, the wireless carrier is subject to ILEC access charges only at the terminating end of the call. Moreover, since CMRS rates are not regulated either by the state commissions or the FCC, CMRS carriers are under no obligation to "impute" any originating access charge into the price they charge for the call. CMRS carriers can thus offer their customers "free" toll calling, whereas IXCs are forced to incur out-of-pocket access charges for the same calls.

The ability of wireless carriers to offer "free" or heavily discounted long distance calling stems directly from the decidedly *unequal* and extraordinarily advantageous treatment that these carriers enjoy with respect to access charges.

The ability of wireless carriers to provide "free" long distance calling arises from a combination of access charge-related conditions that confer enormous and unique competitive advantage to these carriers and confront non-ILEC, non-CMRS carriers with a near-insurmountable competitive barrier. ILEC interstate switched access rates currently average around 1.63 cents per minute for a two-ended call.[5] Wireless calls are considered to be "local calls" when placed to points anywhere within the same MTA in which the calling party is physically located at the time that a given wireless call is initiated, whether intrastate or interstate. Nationwide, there are fifty-one MTAs, many of which encompass entire states or even several states (see Figure 1).

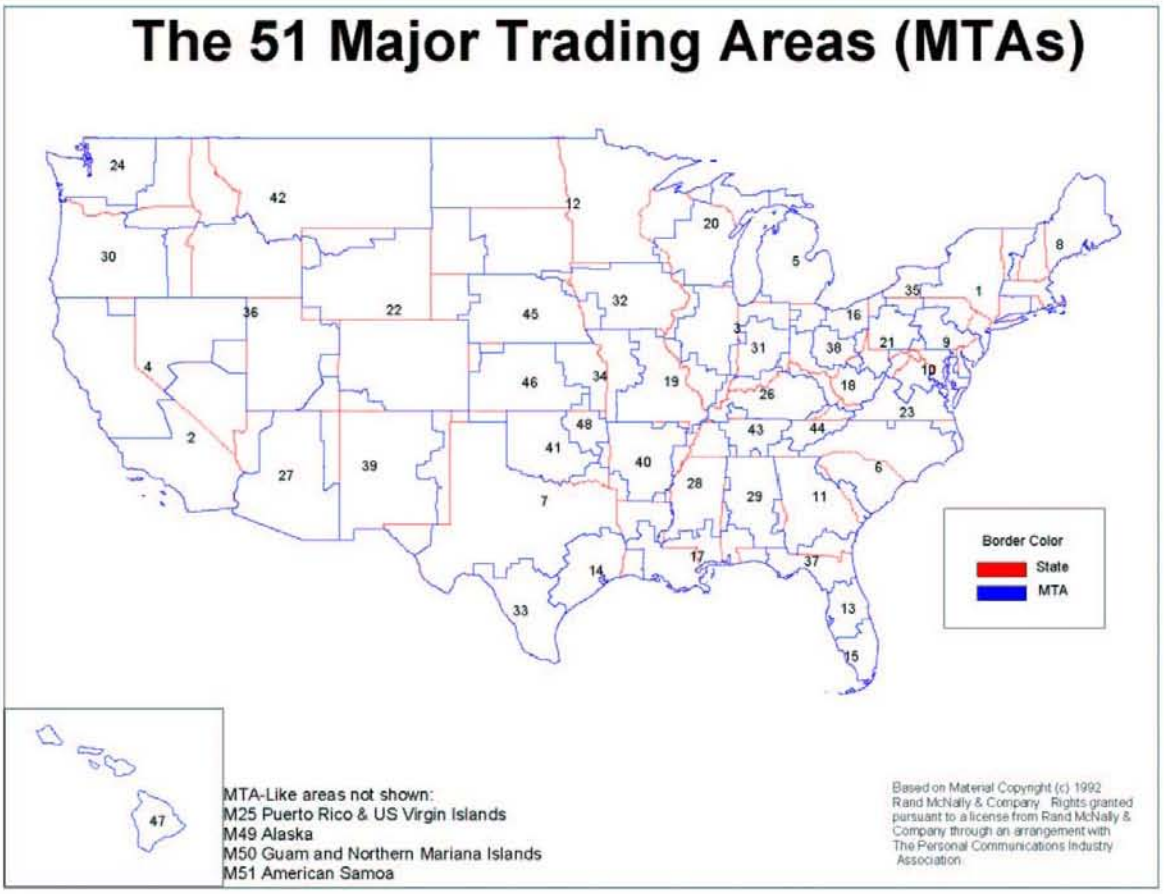


Figure 1. Major Trading Areas ("MTAs") in the United States

5. *FCC Trends in Telephone Service*, February 2007, Table 1.2 (rates in effect through 6/30/07).

Such intra-MTA "local calls" are considered by the FCC to be §251(b)(5) local traffic, which is not subject to intrastate or interstate access charges[6] (see Figure 2). This federal preemption operates to expressly *exempt* wireless carriers from paying access charges on any intra-MTA wireless-originated call, including (and for our purposes in particular) calls to ILEC wireline phones where the terminating number is physically located in a different ILEC local calling area and which would be subject to access charges if placed from a wireline phone. Because many states lie wholly or mainly within a single MTA, wireless carriers are able to terminate most intrastate calls as §251(b)(5) reciprocal compensation traffic, and thus pay no access charges on the vast majority of intrastate calls that their subscribers place within the state. Because many MTAs embrace portions of several states, many *interstate* calls are similarly subject to §252(b)(5) reciprocal compensation treatment.

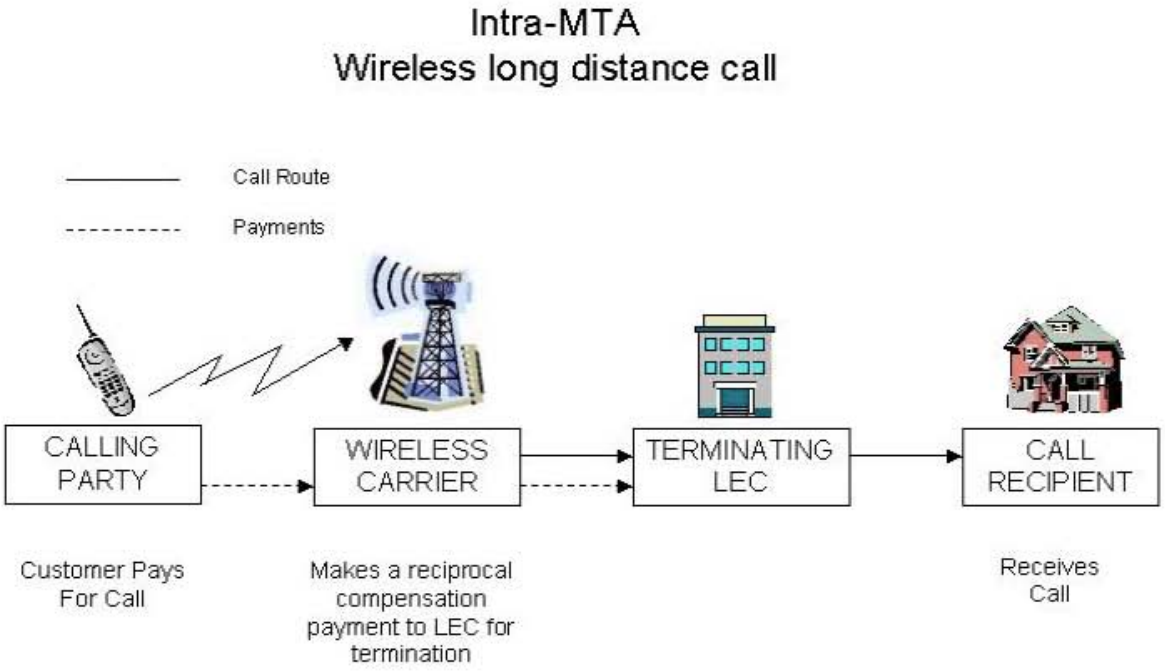


Figure 2. Call routing and flow of payments for wireless-originated intra-MTA long distance call.

6. These intra-MTA calls would, however, be subject to much lower reciprocal compensation payments.

In the case of an *inter*-MTA call, the wireless carrier is required to pay access charges, but only to the LEC at the *terminating* end of the call (see Figure 3). Wireless carriers thus neither pay nor impute *originating* access charges on the wireless end of *any* long distance calls placed by their subscribers, whether charged on a by-the-call basis or bundled into the wireless service pricing plan, and pay terminating access charges only on inter-MTA calls.

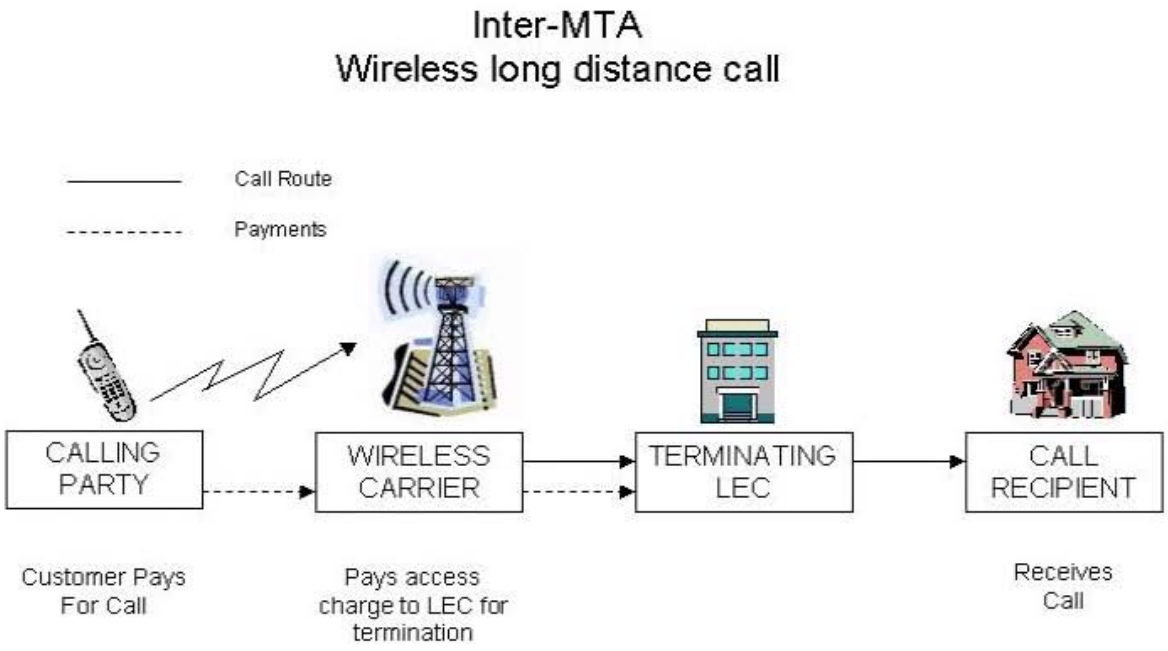


Figure 3. Call routing and flow of payments for wireless-originated inter-MTA long distance call.

These minimal out-of-pocket costs for access make it possible for wireless carriers to offer their subscribers "free" long distance services, something that wireline IXCs could not possibly do without incurring substantial out-of-pocket losses. The *1996 Act* granted authority to RBOC-affiliated CMRS carriers to provide interLATA long distance services as of the date of enactment, without first having to satisfy the entry requirements at sec. 271 applicable to the

RBOCs' ILEC entities.[7] Long before all of their *wireline* ILECs had obtained Section 271 authority (by 2003), wireless carriers had succeeded in siphoning off a large fraction of all consumer-initiated long distance calling, primarily via rate plans that offered such service without any additional long distance toll charges. Between 2000 and 2003, FCC data indicate that wireline number of long distance toll calls had dropped from 106-million to 81-million (and had dropped further, to 77-million by 2005), over a period of time that largely predated the entry of "over-the-top" and other VoIP providers.[8] This trend is continuing. A recent Yankee Group study found that consumers with wireless services make 68% of their long distance calls using their wireless service from their home.

By selectively exempting intra-MTA wireless calls from both state and interstate switched access charges while maintaining access charge treatment for the corresponding *wireline* calls, the Commission has through this regulatory fiat chosen wireless technology to be the "winner" over wireline. Significantly, whatever access charge advantage certain VoIP providers are said to enjoy relative to circuit-switched carriers has had only a minimal impact upon the total long distance market share being maintained by incumbent LECs and incumbent CMRS carriers. The number of wireless long distance calls that are exempt from access charge may be several orders-of-magnitude greater than the number of VoIP calls that are not at present subject to access charges. Granting AT&T's Petition will impose large cost increases on a category of competitors that still control only a single-digit share of the long distance market, while leaving entirely unaddressed the far more extensive wireless intra-MTA access charge exemption that has and will continue to confer enormous financial and competitive benefits upon AT&T's and other RBOCs' wireless operations.

7. § 271(b)(3); § 271(g)(3).

8. Yankee Group, *One in Seven US Households Say "No Thanks" to Wireline Phone Service in 2010*, December 2006, p. 4.

Attachment 3

THE TRUE ECONOMIC IMPACT OF THE "MISSOULA PLAN" FOR INTERCARRIER COMPENSATION: An Assessment Based on Reality

Lee L. Selwyn

November 2006

ECONOMICS AND TECHNOLOGY, INC.

THE TRUE ECONOMIC IMPACT OF THE "MISSOULA PLAN" FOR INTERCARRIER COMPENSATION:

An Assessment Based on Reality

Lee L. Selwyn

November 2006

ECONOMICS AND TECHNOLOGY, INC.

TWO CENTER PLAZA, SUITE 400 • BOSTON, MASSACHUSETTS 02108 • (617)-227-0900

THE TRUE ECONOMIC IMPACT OF THE "MISSOULA PLAN" FOR INTERCARRIER COMPENSATION: AN ASSESSMENT BASED ON REALITY

TABLE OF CONTENTS

Tables

THE TRUE ECONOMIC IMPACT OF THE "MISSOULA PLAN" FOR INTERCARRIER COMPENSATION: AN ASSESSMENT BASED ON REALITY

Lee L. Selwyn[1]

Executive Summary

The *Missoula Plan* for resolving the various intercarrier compensation and access charge disparities calls generally for reductions in local exchange carrier ("LEC") switched access charges and certain other usage-based fees, with incumbent LECs ("ILECs") being afforded the opportunity to offset these rate decreases, dollar-for-dollar, on an entirely *revenue-neutral* basis by increases in various fixed monthly charges. The Plan will almost certainly impact consumers economywide, and assessing these impacts (whether negative or positive) is a critical element in evaluating its overall reasonableness. Richard Clarke and Thomas Makarewicz ("CM"), both of AT&T, have attempted to show that adoption of *Missoula* would produce sizable gains in aggregate economic welfare, concluding that "the economy-wide benefits of these various reforms may reach $54 billion during the eight year period after plan initiation." The CM model might potentially be useful for gauging the end-result of the *Missoula Plan*, but only if the underlying assumptions and input data were valid. However, the specific scenario CM have examined is based upon flawed assumptions and data (some of which directly contravene the Plan itself), resulting in a grossly overstated estimate of any economywide benefit.

Critical to the CM model is its assumption that 100% of the access charge reductions prescribed by *Missoula* will be flowed through to consumers in the form of lower prices. But the Plan itself provides for no such mechanism, and the prevailing state of market concentration and integration make 100% flow-through – or anything close to it – extremely unlikely. CM assume that states adopt and implement *Missoula* access charge reductions immediately. They rely upon own-price elasticities of demand for toll and wireless services that were developed in the distant past, and which are clearly no longer applicable to current pricing and market conditions. CM also assume that all toll and wireless minutes are priced and sold on a per-minute basis, ignoring the preponderance of block-of-time and unlimited usage plans and service bundles. All of these assumptions, individually and in combination, contribute to a grossly exaggerated assessment of *Missoula's* economic benefits. CM also misapply regional multiplier effects that further inflate those overstatements of consumer benefits. When the various flawed assumptions are replaced with more realistic inputs, rather than showing a $54-billion consumer benefit, the model suggests that adoption of *Missoula* could result in massive *negative* economic impacts in the range of $39- to $44-billion. And if incumbent LECs and their parent corporations are enabled via *Missoula's* "revenue-neutrality" requirement to maintain – and, in fact, significantly *increase* – their already excessive rate and earnings levels, they will have the ability to maintain and enlarge their already formidable economic war chest so as to cross-subsidize entry into new markets and new technologies, further distorting economic choices as between incumbent and competitor services. Clarke and Makarewicz have given no account whatsoever for this potentially enormous source of economic loss.

---

1. The author is President, Economics and Technology, Inc. ("ETI"). This report was prepared at the request of Alltel Communications, Inc., Cavalier Telephone, McLeodUSA, National Cable & Telecommunications Association, NuVox, Inc., Pac-West Telecomm, Inc., RCN Telecom Services, Inc., and XO Communications, LLC. The views expressed herein are, however, solely those of the author, who gratefully acknowledges the assistance of Colin B. Weir of ETI in the preparation of this report.

I. Overview

The *Missoula Plan* for resolving the various intercarrier compensation and access charge disparities[2] calls generally for reductions in local exchange carrier ("LEC") switched access charges and certain other usage-based fees, with incumbent LECs ("ILECs") being afforded the opportunity to offset all of these rate decreases, dollar-for-dollar, on an entirely *revenue-neutral* basis.[3] The offsetting ILEC rate increases would include various fixed monthly charges, such as increases in the federal Subscriber Line Charge ("SLC") and carrier universal service fund (USF) contributions,[4] as well as a new "Restructure Mechanism" ("RM"). In addition, and while state-level compliance with the provisions of *Missoula* is mandatory only as to *terminating* switched access charges, any reductions in *intrastate* switched access charges would also be offset through *interstate* SLC rate increases and other rate increases that would operate to satisfy the Restructure Mechanism target. In aggregate and after the transition steps have been completed, the *Missoula Plan* contemplates total annual switched access charge reductions of $6-billion, to be offset through $4.7-billion in annual SLC increases and the remaining $1.3-billion to be raised via the Restructure Mechanism.[5] *Missoula Plan* proponents explain that total Restructure Mechanism costs will be $1.5-billion and identifies an additional $725-million in USF increases which, together with the $4.7-billion in SLC increases, brings total end-state *Missoula* end user rate increases to approximately $6.9-billion, almost $1-billion more than *Missoula* reduces access charges.[6]

The *Missoula Plan* has numerous and serious shortcomings, not the least of which is its disparate treatment of incumbent and competitive carriers and massive jurisdictional shifts of revenues from intrastate to interstate without a corresponding transfer of costs. The purpose of this paper is not, however, to detail the numerous infirmities of the *Missoula Plan*, but to focus upon claims being advanced by its proponents as to its potential economic benefits for the US economy generally. These purported economic benefits are outlined in a paper by Richard Clarke and Thomas Makarewicz, both of AT&T, that was presented by *Missoula* proponents concurrently with the Plan's filing in their July 24, 2006 *ex parte* submission to the FCC. Clarke and Makarewicz ("CM") have attempted to demonstrate that adoption of *Missoula* would produce sizable gains in aggregate economic welfare, concluding that "the economy-wide

---

2. *The Missoula Plan for Intercarrier Compensation Reform* dated July 18, 2006 ("Missoula Plan" or "Missoula"), filed as an *ex parte* submission on July 24, 2006.

3. "The Plan gives incumbent local carriers an opportunity to recover lost intercarrier compensation revenues through supplemental sources of recovery. These sources include increased subscriber line charges ("SLCs") as well as a new Restructure Mechanism, which is designed specifically to *replace switched carrier-to-carrier revenues lost by carriers participating in the Plan* and not otherwise compensated for that loss through end-user charges." *Missoula Plan Executive Summary*, July 18, 2006, at 1, emphasis supplied. Importantly, the Plan affords no corresponding "make whole" mechanism for CLECs.

4. USF assessments are imposed upon *carriers* that may then recover them through carrier-defined surcharges applied to customer bills.

5. *Missoula Plan*, at 100.

6. *Id.*, Executive Summary, at 13. Although the $1.5-billion RM funding estimate includes approximately $200-million for CLECs, the Plan does not include provisions for CLECs to draw from the RM.

benefits of these various reforms may reach $54 billion during the eight year period after plan initiation."[7] As I shall demonstrate through the analysis described below, their forecast suffers from a number of flawed assumptions, is inconsistent with the *Plan* itself, and grossly mischaracterizes the impact on the overall national economy.

This paper is organized as follows. Section II examines the "revenue neutrality" aspect of the *Missoula Plan*, and explores the apparent inconsistency between claims of "savings" to be realized by most residential customers and rate realignments that are supposedly revenue-neutral. In fact, and as confirmed by data provided in the Clarke/Makarewicz paper, rather than being revenue-neutral, *Missoula* will result in multibillion dollar windfall gains for the wireline ILECs.

Section III presents a detailed examination of the specific assumptions underlying the CM "economic benefits" claim, and shows them to be both unsupported and, more importantly, fundamentally invalid. In fact, when these flawed assumptions are corrected, the CM model reveals that adoption of the *Missoula Plan* will actually produce substantial *losses* to the economy overall. Finally, Section IV addresses CM's incorrect application of a "multiplier" to the claimed economic benefits and several other apparent inconsistencies between the details of the *Missoula Plan* and the specific data inputs to the CM model.

II. Revenue Neutrality

The central, overarching principle underlying *Missoula* is its *revenue neutrality* feature. Irrespective of their existing level of earnings, individual incumbent local exchange carriers (ILECs) are to be *made whole* with respect to any reductions in access and other usage-based fees. ILEC rate levels (viewed across their entire mix of services) that are excessive prior to *Missoula* will remain at least as excessive following its adoption and implementation. At the end of the day and holding demand for each category of service constant, the various rearrangements and restructuring of intercarrier compensation are proffered as resulting in *no net change* in aggregate payments for telecommunications services overall, although *individual customers* and customer groups may experience either decreases or increases in their respective monthly bills. If the Plan is truly revenue-neutral in its operation, it follows that whatever net economic benefit the Plan creates must arise only as a result of the potentially more efficient rate structure that the Plan contemplates – i.e., when excessive usage-based switched access charges are brought closer to cost, thereby stimulating more efficient *downstream* consumption and production decisions with respect to usage-based services. But those efficiencies will be realized if and only if the various reductions in usage-based charges are directly, fully and immediately *flowed through* dollar-for-dollar to residential and business *customers* of the various retail telecommunications services that depend upon ILEC switched access. *Missoula* nowhere *requires* such flow-through, and if it does not occur there is little basis to expect that any significant downstream consumption efficiency gains will arise.

7. Richard N. Clarke and Thomas J. Makarewicz, "Economic Benefits from Missoula Plan – Reform of Intercarrier Compensation," AT&T Inc. (Exhibit 2 to *The Missoula Plan for Intercarrier Compensation Reform* dated July 18, 2006 ("Missoula Plan" or "Missoula"), at 1.

Excluding the so-called "multiplier effect" (which I address in Section IV below), CM project "cumulative plan benefits" over the initial eight years of the Plan totaling $41.48-billion.[8] Elsewhere, CM describe that same $41.48-billion as "increased consumer surplus."[9] A relatively small portion of that figure – only about 19% – represents the gain in consumer surplus arising from the authors' projection of the demand stimulation resulting from the reduced access prices which, as I explain in Section III below, is grossly exaggerated and unrealistic.

The disconnect here is that the *Missoula Plan* is supposed to be revenue-neutral, which means that the access charge decreases are to be offset, dollar-for-dollar, by rate *increases* elsewhere. But even excluding the effects of assumed demand stimulation, the CM model projects some $15-billion in net reductions in wireline ILEC revenue (over the first eight years of the plan) resulting from decreases in access charges offset by increases in SLCs, USF surcharges, and any additional (albeit unspecified) payments associated with the Restructure Mechanism (see Table 3 below). So how can a purportedly revenue-neutral rate rebalancing mechanism result in some $15-billion in net *rate reductions* for consumers? Either some portion of the offsetting rate increases have been understated or omitted in the CM analysis or access reductions have been overstated, or customers who will be experiencing a net rate increase have been excluded from the model. According to the proponents of *Missoula*, most *residential customers* will experience a net reduction in their monthly wireline and wireless bills.[10] However, in order for the Plan to achieve the required *revenue-neutrality*, other customers and customer groups not specifically identified in the *Missoula* documentation will necessarily be forced to pay more. Although we do not know precisely who these customers are, they appear to have been essentially overlooked by the CM model.

The magnitude of access charge reductions as called for in the *Missoula Plan* appears to have been grossly overstated and exaggerated in the CM analysis.

Appendix D to the *Missoula Plan* description reports on the results of a modeling effort attributed to AT&T. There is no indication that this "AT&T Model" was also developed by Clarke and Makarewicz or that they had any involvement in its construction. Indeed, that appears highly unlikely, since the results of the "AT&T Model" are dramatically different from those being reported by CM:

> For all incumbent LECs in aggregate, total annual switched access revenues are estimated to be about $8.9 billion. In the pricing scenario presented here, these revenues decline by nearly $6 billion under the Plan. This reduction is offset by $4.7 billion from increased Subscriber Line Charges and $1.3 billion in funding from the new Restructure Mechanism. Estimated funding from the Restructure Mechanism includes $320 million for Track 1 carriers, $548 million for Track 2 carriers, and $458 million for Track 3 carriers, with an additional $125 million estimated

8. *Id.*, at 9.

9. *Id.*, at 10.

10. See Exhibit 1 to the Missoula Plan. The Exhibit provides before and after monthly bills for fourteen (14) *residential* service arrangements, including wireline, wireless, DSL and VoIP. Net decreases are projected for eleven (11) out of these fourteen configurations, with monthly savings ranging as high as $14 (for the wireline urban high-use customer). Three categories would confront small monthly increases of between $0.10 and $2.05.

for CLECs. These calculations are all based on the use of base period (generally 2004) demand volumes.

Although the $1.5-billion RM funding estimate includes approximately $200-million for CLECs, the *Plan* does not include provisions for CLECs to draw from the RM. The CM model also incorporates the effects of assumed demand stimulation (whereas the "AT&T Model" is based upon base period (2004) demand volumes), but even when the effects of demand stimulation are removed from the CM model, its projections of aggregate access charge reductions are *roughly double* those being posited by the *Missoula Plan* itself. More importantly, CM's results are not even close to being revenue-neutral. Table 1 summarizes the CM results maintaining base period demand throughout the entirety of the eight year period:

Table 1

Comparison of Clarke-Makarewicz and "AT&T" Models
Annual changes from Step 4 onward (assuming no demand stimulation)

	Clarke-Makarewicz			"AT&T Model"		
	Access charges	SLC/USF	Net change	Access charges	SLC/USF	Net change
Wireline	– $8.4-billion	+ $6.1-billion	– $2.3-billion	– $6-billion	+ $4.7-billion SLC + $1.3-billion USF*	$0
Wireless	– $4.1-billion	+ $0.8-billion	– $3.4-billion			
Total	– $12.5-billion	+ $6.9-billion	– $5.6-billion	– $6-billion	+ $6-billion	$0

* This figure does not include RM funds for CLECs or additional USF funds contemplated by the *Plan.*

CM project incremental annual access charge reductions for wireline toll service of $2.1-billion at base period demand, accumulating to an aggregate $8.4-billion decrease (relative to pre-*Missoula* levels) at Step 4 and thereafter. They project annual incremental SLC and USF increases at $1.53-billion, reaching $6.11-billion at Step 4 above pre-*Missoula* rates. On the wireless side, CM project a cumulative access charge reduction relative to pre-*Missoula* levels of approximately $0.00175 when spread across all wireless minutes (only some of which are subject to access charges). For purposes of this analysis, I have maintained per-line *usage* levels at the base year volumes given by CM (791 minutes per month), but have used CM's projection of total wireless phones as of Step 4 at 249.5-million, since the growth in demand for wireless phones is unrelated to any reductions in per-minute usage charges. CM project monthly per-line USF increases at 26.15 cents per month through Step 4, which aggregates to $783-million in annual additional USF collections from wireless customers from Step 4 onward.

According to CM and ignoring any theoretical demand stimulation, ILECs will be receiving some $12.5-billion *less* in switched access charge revenues following the full 4-step transition than they did prior to the onset of the *Missoula Plan*. This result is particularly remarkable inasmuch as *total ILEC switched access revenue* is estimated to be only $8.9-billion in the "AT&T Model." The CM estimate of wireless access charge reductions also appears excessive. According to CM, the average reduction in wireless

access charges for those originating wireless minutes that are subject to access charges is $0.00926.[11] CM estimate that 60% of wireless minutes are originating, and that 30% of those minutes are subject to access charges. Spreading the $0.00926 access charge across all wireless minutes (also adjusting for a small change in wireless reciprocal compensation rates), CM compute an average wireless per-minute access charge reduction at $0.00175.[12] CM do not provide a source for their $0.00926 figure. However, an Intercarrier Compensation Forum ("ICF") *ex parte* document puts average wireless switched access charge payments to ILECs at $0.006 for inter-MTA CMRS-to-ILEC calls, and at $0.002 for intra-MTA CMRS-to-ILEC calls.[13] CM also provide no source for their assumption that 30% of originating wireless minutes involve access charges; I seriously doubt that the incidence of wireless calls subject to access charges anywhere near that high.

This gross overestimate of aggregate access charge reductions is clearly at odds with the specific precepts of the *Missoula Plan*. It is hardly surprising that CM's estimate of a net decrease in total ILEC revenues exceeding $5-billion annually following the completion of the 4-step transition would drive their conclusion of massive consumer welfare gains. Of course, *Missoula* does not contemplate *any* net reduction in ILEC revenues, undermining and invalidating the CM "welfare gain" forecast at its most fundamental level. However, rather than simply stop at this point, and for purposes of discussion, let us accept CM's rate effect inputs at face value. Even with their massive exaggeration of *Missoula*-driven access charge reductions, however, CM's "welfare gain" calculation cannot withstand scrutiny.

Massive windfall revenue gains for the ILECs

Significantly, if CM's projected wireline toll demand stimulation is accurate, then rather than being revenue-neutral, *Missoula* will produce enormous windfall revenues for the ILECs, revenues that have been excluded from the Plan's net revenue neutrality calculation. CM assume that the access charge reductions contemplated in the Plan are flowed-through, dollar-for-dollar, as correspondingly lower retail long distance toll rates. Customers presumably respond to these lower prices by purchasing additional long distance minutes. These presumed additional purchases replace a portion of the ILEC's access charge revenues that had been lost due to the reduced access charges, and also result in substantial additional *retail* revenues for the long distance carrier. For example, the CM model starts out with a base year volume of 582.3-billion wireline long distance minutes each of which is assumed to produce an average of $0.05 in retail toll revenues.[14] In Step 1 of the *Missoula Plan*, wireline ILEC access charges are reduced by $0.0036 per minute, which CM assume is flowed through into the retail long distance price, bringing it down to $0.0464, a 7.2% decrease. As a result of that lower price, retail toll demand increases to 614.6-billion minutes, i.e., an increase of 32.3-billion minutes. At an average retail price of $0.0464 per minute, that represents about $1.497-billion in additional *retail* toll revenues. A portion of those additional retail

11. Clarke/Makarewicz, at 7.

12. *Id.*, at 7, footnote 13.

13. *Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, *Ex Parte Brief of the Intercarrier Compensation Forum*, filed October 4, 2004.

14. Clarke/Makarewicz, at 2.

revenues (roughly $578-million) is paid over to the ILECs as additional access charges, with the remaining ($918-million) being retained as additional gross profit by the retail long distance provider (which is, in today's markets, quite often the ILEC itself). However, under the terms of the *Missoula Plan* itself, *neither of these additional sources of access charge or toll revenue are included as offsets to the reduced access charges in determining the increases in SLC, USF, and RM revenues necessary to maintain revenue-neutrality.*

There is no question but that the additional access charge revenues arising from any demand stimulation should be recognized as offsets to the purportedly revenue-neutral fixed line rate increases. If the demand stimulation occurs as CM predict, the ILECs will receive these additional access revenues as a direct consequence of the *Missoula* access charge reductions.[15] But what about the retail toll revenues arising from the stimulated demand? In the past, when RBOCs were not allowed to provide long distance service and when the IXCs that did provide long distance were separate companies, exclusion of the added retail IXC toll revenues would have been appropriate in evaluating the effects of this type of rate rebalancing upon aggregate *ILEC* revenues. But that is decidedly *not* the current environment. Each of the seven original RBOCs have merged, or are about to merge, with a major interexchange carrier. The Section 272(a) separate long distance affiliate requirement has now sunset in all RBOC jurisdictions, enabling the RBOCs to fully integrate their respective ILEC and IXC operations into a single entity. "Stand-Alone Long Distance" ("SALD") providers – those that do not offer integrated local/long distance packages – have all but disappeared. Table 2 demonstrates that if the demand stimulation that CM project actually materializes, according to the CM analysis total stimulated retail long distance revenues (including the access charge component) will sum to about $37.6-billion over the initial eight years following the initiation of the *Missoula Plan*. $8.51-billion of this amount represents additional access charge revenue that ILECs will collect (or impute) but that have not been included as a revenue offset in *Missoula*. A substantial portion of the remaining $29.1-billion of the retail long distance revenue margin will inure to the same ILEC entities that provide access services to the extent that they are also their (ILEC) customers' long distance carrier. If we assume, for example, that over the initial eight years following initiation of the *Missoula Plan* an average of 80% of ILEC customers purchase their long distance service from their ILEC,[16] then roughly 80% of that additional $29.1-billion in retail toll revenue (over and above access charge payments) – i.e., about $23.3-billion – will also inure to the ILECs. Like the stimulated access revenues, these revenues are

15. During the initial access charge rebalancing that occurred between 1984 and 1989, SLC increases were offset by reductions in the Carrier Common Line Charge ("CCLC"), and the then dominant long distance carrier, AT&T Corp., was required to flow-through CCLC reductions in retail toll rates. In calculating the dollar amount of the offset that was required to preserve revenue neutrality, the FCC adjusted for the demand stimulation that was anticipated to result from the lower retail toll prices. *See, MTS and WATS Market Structure; Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, CC Docket No. 78-72; CC Docket No. 80-286, *Memorandum Opinion and Order*, 1985 FCC LEXIS 3824, Rel. February 26, 1985, at para. 4. No corresponding demand adjustment has been incorporated into the fixed line rate increases to be imposed under *Missoula* to offset the access charge reductions.

16. The FCC Industry Analysis and Technology Division's most recent report on *Local Telephone Competition: Status as of December 31, 2005* (issued July 2006) at Table 6 puts total ILEC share of presubscribed residential lines at 58%, for business lines at 38%, or 51% overall. These figures do not include the post-merger reclassifications of MCI presubscribed lines in Verizon territory, or of presubscribed AT&T lines in BellSouth territory, as ILEC presubscribed lines. Further erosion of stand-alone long distance customers and CLEC residential shares will continue to push ILEC LD PIC shares upward. Viewed over the full eight years following *Missoula* initiation, 80% ILEC LD share is a reasonable estimate.

not included as revenue offsets when determining the additional SLC, USF and RM revenues necessary to achieve revenue neutrality under *Missoula*.

Table 2

Aggregate Eight-year Impact of the Missoula Plan
upon ILEC and ILEC Affiliate Revenues
Based Upon Clarke/Makarewicz Demand Stimulation and Flow-Through Projections

	Revenue source	Increase (decrease)	Notes
1	Access charge reductions	($63.7-billion)	Includes effects of purported demand stimulation
2	Scheduled SLC, USF, RM increases	$39.6-billion	
3	Subtotal	($24.2-billion)	L1 + L2
4	Additional wireline LD revenues net of access charges from stimulated toll minutes	$29.1-billion	
5	Additional ILEC LD affiliate revenues net of access charges from stimulated toll minutes	$23.3-billion	L4 x 80%. Assumes 80% of ILEC customers select ILEC as their long distance carrier
6	Additional ILEC revenues from stimulated wireline access minutes	$8.5-billion	
7	Aggregate net ILEC parent company revenue gain	$7.6-billion	L3 + L5 + L6. Offsets 19.4% of SLC/USF/RM increases

But will the additional demand and other economic gains being forecast by CM materialize as they expect? That seems highly unlikely. As detailed in Section III below, a correct analysis of the aggregate economic effects of *Missoula* is far more complex than the overly simplistic CM model. Even its projection of increased *consumer* surplus is grossly exaggerated and, in fact, may actually be negative. At the very least, the CM analysis needs to be recast to eliminate the numerous and demonstrably false assumptions that underlie it. And when these defects are corrected, rather than a net economic gain of $41-billion, $54-billion, or any other amount, it will become clear that if *Missoula* is allowed to go forward, substantial economic *losses* will surely result.

The economic benefit being projected by the CM model is critically dependent upon its assumption of dollar-for-dollar flow-through of the lower access charges in retail usage prices.

As drafted, *Missoula* would reduce certain *intercarrier payments* while *increasing* certain fixed monthly charges that are imposed *by ILECs* (and other carriers) upon their own retail end-user customers. Because the escalations in line rates – SLCs, USF charges, and charges to be levied under the new "Restructure Mechanism" ("RM") – would all be collected by the ILECs and RLECs directly from their end-user retail customers, flow-through of these rate *increases* into retail end-user rates will surely take place. But flow-through of the *reductions in access charges* in retail usage prices is extremely unlikely to

occur, and absent such flow-throughs, consumers will be paying higher monthly line rates without seeing any of the offsetting decreases in usage-based charges.

The principal sources of competition for ILEC wireline long distance services comes from CLECs that offer local and long distance service bundles, from wireless carriers and, to a considerably lesser extent, from "over-the-top" Voice over Internet Protocol ("VoIP"). For CLECs and cable telephony providers, *Missoula*'s mandated reductions in switched access charges will have virtually no *net effect*: CLEC access charge payments to other carriers to terminate long distance calls placed by their subscribers will decrease, but so too will the access charge *revenues* realized by those same CLECs from other carriers for terminating inbound long distance calls *to their subscribers*. Since originating and terminating long distance minutes are roughly equal, the reduced costs and reduced revenues will net to zero, giving CLECs nothing to flow-through. Wireless carriers already pay far lower access charges than are implicit in wireline long distance prices, and "over-the-top" VoIP providers may pay no access charges at all.[17] Reductions in access charges will thus have little or no effect upon wireless and VoIP retail price levels. For example, according to the CM model, the maximum decrease in wireless carrier access charges after the full four-year implementation of the Missoula Plan amounts to $0.0015 per minute – i.e., 15 one-hundredths of one cent. By contrast, CM estimate full *Missoula* per-minute *wireline* access charge reductions at $0.0144 – i.e., 1.44 cents per minute. Thus, even if wireless carriers were to flow-through their entire $0.0015 per-minute savings in lower retail prices (which, as I show below, is extremely unlikely) and further assuming that this $0.0015 wireless retail price drop forced *wireline* carriers to implement a corresponding price change, that would still allow wireline carriers to retain as additional profit some 90% of the decrease in wireline carrier access costs. Accordingly, it is unrealistic to expect any reductions in retail wireline prices.

Because *Missoula* does not require that carriers flow-through any of the access charge reductions in retail prices charged to end-user customers, such flow-throughs would occur if and only if compelled by competitive marketplace forces. But the elimination of the ILECs' two largest long distance rivals – pre-merger AT&T and MCI – make this extremely unlikely. Because competing carriers would realize little or no net cost savings under *Missoula*, there would be insufficient competitive pressure to discipline ILEC pricing of long distance and other services that rely upon switched access and other intercarrier connections. Post-merger AT&T and Verizon currently control more than 58% of the consumer long distance market within each of their respective ILEC footprints.[18] Following AT&T's merger with BellSouth, the company will dominate local and long distance services in 22 states covering more than half of the entire US population. There is no longer any "stand-alone long distance" competition, so there is little to force AT&T or Verizon to reduce their consumer long distance rates.

---

17. Wireless carriers pay no access charges at the wireless end of a wireless-wireline call, and pay no access charges at all on calls placed between and among their own wireless customers. Wireless carriers also pay no access charges for calls terminating within the same "Major Trading Area" ("MTA"), expansive geographic regions that may include large portions of a state, of several states, or entire states. "Over-the-top" VoIP service providers are not subject to access charges at the broadband end of a VoIP call, since the connection between the customer and the service provider is accomplished via the Internet. The status of access charge treatment of VoIP calls at the "open" (PSTN) end remains ambiguous at this time.

18. *Id.*

Direct flow-through of reductions in costs to the affected services has been shown to be unlikely even where ILEC market shares are relatively low. ILECs currently control only about 39% of the market for consumer high-speed Internet access – the latest FCC data put the number of ILEC ADSL customers at 19.5-million, as compared with 25.6-million using cable modem services.[19] Yet recent events demonstrate that it is unlikely that ILECs will translate cost reductions affecting a particular service into lower retail prices for that service *even where substantial competition is present*. For example, the FCC recently eliminated the requirement that ILECs collect Universal Service Fund surcharges from DSL customers, a change that took effect on August, 2006. Depending upon the type of DSL service involved, these monthly USF fees had ranged between $1 and $3 for typical consumer ADSL service. When the mandatory USF surcharges were eliminated, Verizon and BellSouth immediately replaced the USF fees with new and "made up" surcharges (Verizon referred to them as the "DSL Supplier Surcharge," BellSouth called it the "Broadband Fee") at virtually identical amounts. Not only did Verizon and BellSouth fail to pass along the USF surcharge elimination to their DSL customers, they actually took affirmative steps to *increase their own prices* so as to essentially *replace* them, thus maintaining the "bottom line of the customer's bill" essentially unchanged. Clearly, neither Verizon nor BellSouth felt compelled by cable modem competition to pass along the USF surcharge elimination, choosing instead to maintain the preexisting price point, which their customers had apparently been willing to pay. It was only after receiving a great deal of adverse publicity about this tactic – together with *political* pressure from the FCC – that both Verizon and BellSouth backed down.[20] If flow-through did not occur where the ILECs hold only a minority share of the market, flow-through of access charge reductions in the retail long distance market – a market that ILECs dominate – seems rather far-fetched.

Without any requirement (competitive or otherwise) to flow-through access cost reductions, the ILECs – and the RBOCs in particular – stand to realize massive financial gains. To understand why, it is important to keep in mind that *Missoula's* revenue-neutrality requirement applies solely to the RBOCs' *ILEC entities* and not to the entire corporation. For example, AT&T's long distance entity "purchases" access services at tariffed rates from the AT&T ILECs (e.g., the former SBC operating companies). It also purchases access services from nonaffiliated ILECs, such as those owned by Verizon, Qwest and the various non-Bell ILECs. While the mechanics of these relationships may differ, at least at a superficial level, their economic effect is exactly the same:

- With respect to the "purchases" made by an RBOC's long distance entity from the same RBOC's ILECs, the effect of access charge reductions but without any retail price flow-through is to shift revenues from the ILECs to the long distance affiliate. Under *Missoula*, however, the *ILEC entities'* revenue loss is made up, dollar-for-dollar, through increased SLCs and other nonusage charges, so there is no net loss of profit to the ILECs. However, the long distance affiliate's profit will increase by the precise amount of the reduction in access charge payments it makes to its ILEC affiliates.

---

19. Industry Analysis and Technology Division, Federal Communications Commission, *High-Speed Services for Internet Access: Status as of December 31, 2005*, released July 2006, at Table 1. As of December 31, 2005, there were 19,514,318 ADSL subscribers and 25,583,233 Cable Modem subscribers. Overall, there were a total of 50,237,139 high speed lines in service (200kbps in at least one direction), putting the (primarily ILEC-provided) ADSL share at only 38.8%.

20. See, Verizon News Release, "Verizon Removes DSL Supplier Surcharge," August 30, 2006; BellSouth News Release, "BellSouth Statement on Cost Recovery," August 25, 2006.

- With respect to purchases of access service by, for example, Verizon's long distance affiliate from AT&T ILECs, Verizon's access payments will decrease, and without flow-through those savings will be retained as additional profits. Concurrently, AT&T's long distance affiliate will be paying less for access to the Verizon ILECs, capturing those savings as additional profits for AT&T. Both the AT&T and the Verizon ILECs will, of course, be receiving correspondingly less access revenue but, per *Missoula*'s revenue-neutrality feature, will be made whole through increases in SLCs and other fees. Viewed from the perspective of the *parent corporation* rather than from that of the individual ILEC entities, *Missoula* will truly allow them to "have their cake and eat it too." The ILEC entities will be made whole for the loss of access revenues, while the long distance affiliates will convert the access savings on their books into additional, and windfall, profit.

Table 3 demonstrates the financial gain that the RBOCs will realize at the parent company level by virtue of the fact that the *Missoula* revenue-neutrality requirement is confined solely and entirely to the *ILEC* entities. The analysis assumes no flow-through of access savings (and hence no demand stimulation), and further assumes that 80% of ILEC retail customers select the ILEC's long distance affiliate as their presubscribed long distance carrier. As the Table shows, if *Missoula* is adopted and implemented as proposed, the ILEC parent companies stand to realize in the range of $28.7-billion in net financial gain over the initial eight years of the Plan.

Table 3

Aggregate Eight-year Impact of the Missoula Plan
upon ILEC and ILEC Affiliate Revenues
Based Upon CM Model with No Stimulation and No Flow-through

	Revenue source	Increase (decrease)	Notes
1	ILEC Access charge reductions	($54.6-billion)	See Note 1 below
2	ILEC Revenues recovered via scheduled SLC, USF, and RM increases	$39.6-billion	
3	Net change in ILEC entity revenue	($15.0-billion)	L1 + L2
4	Additional revenues that inure to wireline LD carriers due to decreased access costs and no flow through	$54.6-billion	
5	Additional revenues that inure to ILEC LD affiliate due to decreased access costs and no flow through	$43.7-billion	L4 x 80%. Assumes 80% of ILEC customers select ILEC as their long distance carrier
6	Aggregate net ILEC parent company revenue gain	$28.7-billion	L3 + L5. Offsets 72% of SLC/USF/RM increases

Note 1: CM's projection of $54.6-billion in aggregate access charge reductions is inconsistent with the projection developed by the Missoula Group as reflected in the "AT&T Model" in Appendix D. There, end-state annual access charge decreases are shown as $6-billion, implying aggregate 8-year reductions (reflecting initial phase-in) of only $39-billion. If that figure were substituted for CM's $54.6-billion, the aggregate net ILEC parent company revenue gain would be approximately $31-billion.

III. The Clarke/Makarewicz Consumer Benefits Analysis

The CM analysis is driven by a series of unsupported and unrealistic assumptions, all of which serve to inflate and exaggerate the likely benefits of the Plan. CM also misapply economywide multiplier effects, again serving to overstate the purported benefits of the Plan. The only means by which the various reductions in switched access and other intercarrier compensation rate components would result in a *bona fide* and substantial economywide benefit is through the elimination of *revenue neutrality* and the various corporate welfare payments and protections that the incumbent carriers have hard-wired into *Missoula*. Significantly, Clarke and Makarewicz do not explore the substantial potential benefits to consumers that would arise if the *Missoula Plan did not* require intercarrier compensation reform to be revenue neutral.

The Clarke/Makarewicz economic benefits model is critically dependent upon several key, yet entirely flawed, assumptions as to the specific effects of the Missoula Plan

The flawed assumptions underlying the CM analysis

The CM model is driven by a series of critical assumptions regarding the likely responses of service providers to *Missoula's* lower access prices and the likely responses of consumers to such changes, if any, in *retail* end-user prices that may ensue. Each and every one of these assumptions is unsupported by the authors and all are, to put it simply, incorrect. The model assumes:

(1) That 100% of access charge reductions will flow through to consumers in the form of lower retail prices available to end-user consumers;

(2) That 100% of the intrastate access charge reductions prescribed by the Plan are adopted by state commissions and are fully flowed through in end-user retail prices;

(3) That the price elasticity of demand for long distance toll service is -0.72;

(4) That the price elasticity of demand for wireless service is -1.29;

(5) That cross-price elasticities among alternate telecom technologies are zero and can be ignored; and

(6) That all wireline and wireless long distance minutes are priced and sold on a per-minute-of-use basis.

These assumptions are highly interrelated: Even if less than all of them are wrong (and *all* of them *are* wrong), the CM model would fail to accurately capture and calculate the economic effects of the Plan. Customers will respond to lower *retail* usage charges, not lower *wholesale* usage charges. Retail usage charges will be reduced only if retail service providers (ILECs and non-ILECs) realize net access rate reductions under *Missoula* and flow through the entirety of such net reductions in the prices they charge their retail end-user customers. Significantly, *Missoula* does not require any such flow-throughs, and retail prices of long distance services provided by the same ILECs and their long distance affiliates that will be allowed to increase fixed line rates and obtain additional revenues via the Restructure Mechanism are largely if not entirely unregulated at both the state and federal levels. So unless carriers realize net reductions and present their retail customers with correspondingly lower retail long distance prices – which they

are compelled neither by regulation nor by competitive marketplace forces to do – consumers will not increase their consumption, irrespective of the applicable price elasticity of demand. However, the CM model and – for that matter – the various impact "illustrations" provided in Exhibit 1 to the *Missoula Plan* document, all assume full and immediate flow-through of all decreases in access charges and other usage-based intercarrier fees. To the extent that less than all – or none – of the access rate reductions result in lower retail prices, the potential demand stimulation and increases in consumer surplus being assumed in the CM model will be attenuated or (if there is no flow-through at all) eliminated altogether.

A key requirement of CM's demand stimulation analysis is that *all wireline and wireless long distance services* be priced on a per-minute-of-use basis, and that it is these per-minute usage charges that will be reduced to correspond with the decrease in switched access rates. If the per-minute access rate is reduced, and if the retail service provider correspondingly reduces its own retail prices by a like amount, the lower per-minute price would create a corresponding increase in consumer surplus and stimulate additional consumption of these services. But what if – as is in fact the case – the retail pricing of such services is on a basis other than per-minute-of-use? Today, a large portion of *wireline* long distance and almost all *wireless* pricing involves either flat-rate (unlimited) or block-of-time calling. Under block-of-time pricing, the customer receives a fixed "monthly calling allowance," usually denominated in minutes-of-use, and (particularly in the case of wireless) is subject to often large "overage" or "overtime" charges if the monthly allowance is exceeded. In order to avoid such penalties, customers often "guess high" when selecting among alternative block-of-time levels. Many wireless pricing plans also include "free" night and weekend calling, usually to anywhere within the US. Once having subscribed for an unlimited or block-of-time calling plan, consumers perceive any incremental minutes as "free." With respect to such plans, to the extent that any flow-through of lower access charges occurs at all, it would most likely take the form of an increase in the monthly calling allowance at prevailing price points rather than as a decrease in monthly charges. Even if flow-through occurs, its effects upon consumer surplus and consumption would be minimal at best.

CM also assume that the basic rate restructuring contemplated in the Plan is implemented both in the *interstate* jurisdiction *and in all 50 states* – in fact, fully 72% of the projected wireline access charge reductions arise at the intrastate level. But *Missoula* makes state PUC adoption of these restructurings voluntary in some respects,[21] although carriers may, beginning at Step 2, "petition the FCC to preempt State authority over Track 1 and 2 carriers' intrastate originating access rates in order to fully implement all of the Plan's terms for those carriers."[22] All else equal, any delay in or failure of state-level implementation, even in some states, will reduce the aggregate number of access minutes whose rates are being reduced and which will be affected, if at all, by demand responses to the (potentially) lower retail prices.

---

21. *Missoula* does not mandate reductions in *intrastate* originating switched access charges for any of the three tracks. Adoption of track 3 terminating intrastate access rates is also voluntary. Under *Missoula,* reductions in *intrastate* access charges are compensated by increases in *interstate* SLC, USF and RM rates, in effect, shifting revenues – but not costs – out of the intrastate and into the interstate jurisdiction. It is, to say the least, less than obvious that state regulators would perceive such an outcome to comport with their state's interests.

22. *Missoula Plan,* at 3.

CM make certain assumptions with respect to the price-elasticity of demand for long distance services as a basis for the projections of potential demand responses. They assume an *own-price elasticity* of -0.72 for wireline long distance calling, and -1.29 for wireless calling. Even assuming full flow-through, full state-level adoption of *Missoula*, and 100% per-minute-of-use pricing, if one or both of these price elasticities are overstated (and as I explain below, both are), the resulting demand stimulation will necessarily be far lower than CM predict. In addition, by focusing solely upon *own-price* effects and ignoring *cross-price elasticities*, the CM model likely overstates net demand stimulation taken across all alternate telecom technologies.

Flawed Assumption 1: 100% flow-through

As previously discussed, CM's assumption of 100% flow-through of access charge savings into lower retail prices is unrealistic in the extreme. Yet the "economic benefits" they seek to ascribe to *Missoula* are critically dependent upon such flow-through actually taking place. Table 4 examines the overall sensitivity of the CM results to the flow-through assumption. Holding all else equal, flow-throughs of 100% through 0%, in 10% increments, of the usage rate decreases contemplated in the *Missoula Plan* are calculated. As the Table demonstrates, at any flow-through level below 54% (and accepting all other CM assumptions), the "economic benefits" of *Missoula* turn decidedly *negative*.

Table 4

Economic gain (loss) of the Missoula Plan
Sensitivity to CM Assumption 1: Flow-through

% of Access charge reductions flowed through to consumers	Effect on wireline consumers	Effect on Wireless consumers	Overall Effect of Missoula Plan
100%	$21.1-billion	$19.4-billion	$41.5-billion
90%	$14.4-billion	$16.9-billion	$32.3-billion
80%	$7.9-billion	$14.5-billion	$23.3-billion
70%	$1.5-billion	$12.1-billion	$14.5-billion
60%	($4.8-billion)	$9.7-billion	$5.9-billion
50%	($10.9-billion)	$7.3-billion	($2.6-billion)
40%	($16.9-billion)	$4.9-billion	($11.0-billion)
30%	($22.7-billion)	$2.6-billion	($19.2-billion)
20%	($28.5-billion)	$0.2-billion	($27.2-billion)
10%	($34.1-billion)	($2.1-billion)	($35.2-billion)
0%	($39.6-billion)	($4.4-billion)	($43.0-billion)

Flawed Assumption 2: 100% of intrastate access charges prescribed by the Plan are adopted by state commissions and flowed-through in correspondingly lower retail prices

The *Missoula Plan* includes many components, only some of which are mandatory. In particular, any reductions in or elimination of *intrastate* originating access charges contemplated by the Plan are only *suggestions*, the implementation of which would require state-by-state regulatory action. In their analysis of the economic effects of Plan, Clarke and Makarewicz assume that all of the intrastate access charge reductions are adopted concurrently with the *interstate* rate changes that are called for by the Plan. While the *Missoula Plan* does provide certain incentives to encourage states to adopt the entire *Plan*, there can be no assurance that full state-level adoption with occur under the same transition schedule as is anticipated for interstate services. If some states fail to adopt the *Plan*, or are unable to complete the necessary proceedings to implement that *Plan* in time to provide all of the potential consumer benefits outlined by Clarke and Makarewicz, their projections of economic gains are overstated. Table 5 below examines the sensitivity of the CM projections to the state adoption assumption. Alternative levels of state PUC adoption of *Missoula* rate rebalancing are examined at 10% increments.

Table 5

Economic gain (loss) of the Missoula Plan
Sensitivity to CM Assumption 2: Intrastate Adoption

% State adoption of voluntary Access charge reductions	Effect on wireline consumers	Effect on Wireless consumers	Overall Effect of Missoula Plan
100%	$21.1-billion	$19.4-billion	$41.5-billion
90%	$18.7-billion	$18.7-billion	$38.3-billion
80%	$16.3-billion	$17.9-billion	$35.2-billion
70%	$13.9-billion	$17.2-billion	$32.1-billion
60%	$11.6-billion	$16.5-billion	$29.1-billion
50%	$9.2-billion	$15.8-billion	$26.0-billion
40%	$6.9-billion	$15.1-billion	$23.0-billion
30%	$4.6-billion	$14.4-billion	$20.0-billion
20%	$2.3-billion	$13.7-billion	$17.0-billion
10%	$0.0-billion	$13.0-billion	$14.0-billion
0%	($2.2-billion)	$12.3-billion	$11.1-billion

Flawed Assumption 3: The price elasticity of demand for long distance toll service is -0.72

The CM analysis anticipates that the lower long distance rates that will be offered to consumers as carriers flow-through the decreases in access charges and other intercarrier payments in their retail prices will stimulate increased usage of the retail long distance services. The quantification of such demand stimulation is based upon an assumed *own-price elasticity of demand* of -0.72. Clarke and Makarewicz obtain that particular value (-0.72) from ancient sources that are not applicable to current market and pricing conditions. While the specific references they cite have 1999 and 2002 dates, an examination of the

cited writings reveals that their sources for the -0.72 value come from other, much older studies (1994 and 1993, respectively). CM also cite a 1980 monograph by Lester Taylor, which reports the results of toll price elasticity studies conducted between 1970 and 1975. These woefully out-of-date sources describe the price elasticity of demand for toll services applicable during a time when long distance toll prices ranged from approximately $1.00 per minute to $0.50 per minute (expressed in nominal dollars), which is a far cry from the *current* 2006 long distance price level of $0.05 per minute or less (CM assume a price of $0.05 per minute).[23]

Any estimate of the price elasticity of demand for a given product or service is accurate only within a small range of prices, and must be recalculated for any significant change in price level. In particular, and all else equal, the price elasticity for a given product or service tends to *decrease* as the price of that product or service decreases. At a price of $1.00, a 50% price drop represents a 50 cent decrease. However, at a price point of only $0.02, a 50% price drop represents only a one cent decrease. Although the *percentage change* in price for each of these two examples is the same, consumers are far more likely to react to a drop of 50 cents than to a drop of a penny. Thus, a price elasticity estimate that may have been valid and accurate at a $1.00 per-minute price cannot be inferred as being accurate or applicable at the 2 cent price point. In fact, expert testimony offered recently by RBOCs have expressly challenged the use of the -0.72 value in favor of a far lower number, in the range of -0.2 to -0.1, when addressing the matter of toll stimulation in several recent state proceedings.[24]

The CM model associates most of the economic gain from *Missoula* rate restructuring with the increase in consumer surplus resulting from the assumed lower retail prices, with the remainder being attributed to assumed stimulation of additional consumption of the (then) lower-priced retail services. However, the level of demand stimulation being projected by CM is driven by their use of antiquated and excessive own-price elasticity estimates. Substituting more realistic price elasticities appropriate for current long distance price levels will reduce the overall CM projection, as shown in Table 6 below. As with the sensitivity analyses for the other assumptions, all else is being held constant here – i.e., we are assuming 100% flow-through and 100% state-level adoption of the *Missoula* price changes and, of course, we are assuming that all long distance calling is priced to the end-user on a per-minute-of-use basis.

23. Clarke/Makarewicz, at 2.

24. Application Of Qwest Corporation for an Increase in Revenues, Oregon Public Utilities Commission Docket No. UT-125, Rebuttal Testimony of Aniruddha Banerjee on behalf of Qwest Corporation, May 3, 2001.

Table 6 Economic gain (loss) of the Missoula Plan Sensitivity to CM Assumption 3: Toll Price-Elasticity			
Assumed Toll Price Elasticity	Effect on wireline consumers	Effect on Wireless consumers	Overall Effect of Missoula Plan
-0.72	$21.1-billion	$19.4-billion	$41.5-billion
-0.6	$20.1-billion	$19.4-billion	$40.3-billion
-0.45	$18.7-billion	$19.4-billion	$38.8-billion
-0.3	$17.5-billion	$19.4-billion	$37.4-billion
-0.15	$16.2-billion	$19.4-billion	$36.1-billion
0.00	$15.0-billion	$19.4-billion	$34.7-billion

Flawed Assumption 4: That the correct price elasticity of demand for wireless service is -1.29

Clarke and Makarewicz also rely upon an outdated price elasticity study for wireless service that is based upon demand (and prices) for wireless service prevailing during the 1999-2001 time frame. Between 1999 and 2005, average wireless revenue per minute has plummeted by more than 68%, from $0.22 to $0.07.[25] This dramatic reduction in the effective per-minute price for wireless service renders any price elasticity of demand developed for a price point of $0.22 invalid at current "prices." Moreover, as previously discussed, wireless service is typically sold in block-of-time increments rather than on a strict *per-minute-of-use* basis. For customers that do not generally use their entire block of time, a price reduction (assuming flow-through actually takes place) either in the form of more minutes in the block or a lower monthly price for the block) would not be expected to stimulate additional minutes. And for customers who periodically exceed their monthly usage allowance within the block, wireless carrier pricing practices in the US involve the use of *penalty* type prices (in the range of $0.30 to $0.50 per overtime minute), which is so far in excess of any access charge or intercarrier compensation payment that any flow-through, even if it did occur, would be so small in relative terms as to have no discernable impact upon customers' use of these "overtime" minutes. Finally, as also noted above, wireless calls are subject, on average, to far lower access charges than conventional wireline long distance calls, such that even if the entire *Missoula* access reductions applicable to wireless carriers were flowed through in lower retail usage prices, the amounts involved would be extremely small. Wireless carriers pay no access charges at the wireline end of a call, pay no access charges on calls between wireless phones on their respective wireless networks, and pay no access charges on wireless-to-wireline and wireline-to-wireless calls that originate and terminate within the same Major Trading Area. And as to any actual flow-through that might occur, only those consumers that are right on the margin of their calling plan will consider using more wireless minutes as a result of a price decrease in *average* wireless airtime charges.

Table 7 below demonstrates the effect of substituting more realistic estimates of wireless price elasticities for the -1.29 value used in the CM model. As was the case for wireline services, the CM model

25. 11th Annual FCC CMRS Report, WT Docket No. 06-17, Released September 29, 2006, at 106.

associates most of the economic gain from *Missoula* rate restructuring with the increase in consumer surplus resulting from the assumed lower retail prices, rather than from stimulation of additional consumption of the (then) lower-priced retail services. Substituting more realistic price elasticities will reduce the overall CM projection of economic gain. As with the sensitivity analyses for the other assumptions, all else is held constant here.

Table 7

Economic gain (loss) of the Missoula Plan
Sensitivity to CM Assumption 4: Wireless Price-Elasticity

Assumed Wireless Price Elasticity	Effect on wireline consumers	Effect on Wireless consumers	Overall Effect of Missoula Plan
-1.29	$21.1-billion	$19.4-billion	$41.5-billion
-1.00	$21.1-billion	$19.2-billion	$41.2-billion
-.75	$21.1-billion	$19.0-billion	$41.0-billion
-.50	$21.1-billion	$18.9-billion	$40.8-billion
-.25	$21.1-billion	$18.7-billion	$40.6-billion
0.00	$21.1-billion	$18.6-billion	$40.4-billion

Flawed Assumption 5: That cross-price elasticities among alternate telecom technologies are zero and can be ignored

In their assessment of demand effects associated with the assumed retail price reductions, CM consider only *own-price elasticities* and ignore cross-elastic effects. In recent years, consumers have shifted substantial amounts of their long distance calling to their wireless phones largely because they perceive such calls as "free." Unless the customer has elected an unlimited or block-of-time plan for wireline long distance, incremental charges apply for incremental long distance calling. However, as to that customer's *wireless* phone, for calls placed within the monthly calling allowance, to other wireline phones on the same network, or during night/weekend periods, the incremental charge for these incremental minutes is zero. If wireline access charges are reduced or eliminated (thus more closely approximating the access charge conditions wireless carriers currently face), wireline carriers may well adopt "national" calling models in which the distinction between "local" and "long distance" is collapsed, and all domestic – and perhaps even some international – calls become effectively "local." Such a fundamental revision in wireline pricing may well stimulate additional usage, but a good deal of that may well represent a re-shifting of what are now wireless minutes back to the considerably higher quality wireline services. As such, the *net stimulation* of wireline/wireless calling may be minimal, with a good portion of *apparent* increased wireline usage resulting from a shift away from wireless rather than an absolute demand increase.

Flawed Assumption 6: That all wireline and wireless long distance minutes are priced and sold on a per-minute-of-use basis

In their calculation of *Missoula Plan* benefits that might arise for users of wireline long distance toll service, Clarke and Makarewicz mistakenly assume that all wireline toll minutes are subject to per-minute

pricing. Recent RBOC statements to investors and financial analysts have made no secret of the fact that a large percentage of consumers now subscribe to "bundles" of local and long distance services that provide either unlimited or so-called "block-of-time" pricing for long distance calling.[26] These service bundles do not include per-minute pricing, and would not, given the current pricing structure, allow for lower access charges to flow through to consumers via lower per-minute rates. For example, a customer subscribing to a Verizon unlimited long distance plan priced at $35 a month would not see the benefit of reduced access charges even if Verizon lowered its stand alone per-minute toll rates; the only benefit that might arise would come from a reduction in the fixed monthly charge, which would of course be offset through increases in the SLC and other fixed rate elements and surcharges.

Table 8 below analyzes the effects of alternate assumptions regarding the extent of per-minute pricing of wireline and wireless services. At per-minute pricing applicable to less than 52% of all wireline and wireless minutes, and holding all other CM assumptions constant, *Missoula* would produce decidedly negative economic benefits. Given the relatively small percentage of wireline minutes – and the even smaller percentage of wireless minutes – that are actually subject to per-minute pricing, the CM assumption that *all minutes are priced on a per-minute basis* is clearly fatal to their overall conclusion.

Table 8

Economic gain (loss) of the Missoula Plan
Sensitivity to CM Assumption 6: Per-Minute Pricing

% of Minutes Billed on a Per-Minute Basis	Effect on wireline consumers	Effect on Wireless consumers	Overall Effect of Missoula Plan
100%	$21.1-billion	$19.4-billion	$41.5-billion
90%	$15.1-billion	$17.0-billion	$32.9-billion
80%	$9.0-billion	$14.6-billion	$24.4-billion
70%	$2.9-billion	$12.2-billion	$15.8-billion
60%	($3.2-billion)	$9.9-billion	$7.3-billion
50%	($9.2-billion)	$7.5-billion	($1.3-billion)
40%	($15.3-billion)	$5.1-billion	($9.8-billion)
30%	($21.4-billion)	$2.7-billion	($18.3-billion)
20%	($27.5-billion)	$0.4-billion	($26.9-billion)
10%	($33.5-billion)	($2.0-billion)	($35.4-billion)
0%	($39.6-billion)	($4.4-billion)	($44.0-billion)

26. For example, as of the second quarter of 2005, Verizon 60% of customers subscribed to a package or bundle of service. As of second quarter 2006, Verizon had achieved a 22% penetration rate (and a 40% annual growth rate) of its so called "Freedom" bundle which offers consumers unlimited local and long distance calling. *See,* Verizon Communications, *Second Quarter 2005 Earnings Conference Call*, July 26, 2005, transcript at 6, available at http://investor.verizon.com/news/20050726/, and Verizon Communications, *Second Quarter 2006 Earnings Conference Call*, August 1, 2006, transcript at 5, available at http://investor.verizon.com/news/20060801/.

Correcting for the assumptions made by Clarke and Makarewicz not only eliminates all of the economic benefits they ascribe to the Missoula Plan, but confirms that adoption of the Plan will actually result in significant economic harm.

Each of the sensitivity analyses presented above was limited to examining the effects of correcting *individual* CM assumptions in isolation from the others, holding all else constant. However, in order to provide a more complete assessment of the true economic effects of *Missoula*, the sensitivity analysis will need to examine the effects of correcting all of the flawed assumptions that drive the CM model. Ideally, of course, the unsupported CM assumptions should be replaced by specific data, but such information is not readily available. Accordingly, I have constructed three alternative sets of assumptions, and based thereon have calculated the resulting economic gain (loss) that adoption of *Missoula* would engender. Table 9 below summarizes each of these scenarios and compares them to the baseline CM assumptions.

- *Scenario 1* presents what I consider to be the most realistic values for each of the parameters. Thus, for example, the assumption of 100% flow-through is replaced by an estimate of 20% flow-through; the assumption of 100% minutes-of-use retail pricing is replaced by 25% for wireline and 5% for wireless.

- *Scenario 2* presents what might be described as a "best case" condition – i.e., one that is closer to the CM assumptions than what I consider to be realistic.

- *Scenario 3* presents a "worst case" condition, assuming, for example, no flow-through at all, no demand response, and lower values for per-minute pricing.

For convenience, the Table includes the values for each parameter than are implicit in the CM model.

Table 9

Sensitivity Analysis of the Economic Effects of *Missoula*
(excluding multiplier effects)

Assumption	CM model with CM assumptions	Scenario 1: "Realistic" values	Scenario 2: "Best Case" values	Scenario 3: "Worst Case" values
Flow-through of access charge reductions	100%	10%	20%	0%
State adoption of *Missoula* restructuring	100%	50%	75%	25%
Price elasticity – wireline	-0.72	-0.15	-0.3	-0.05
Price elasticity – wireless	-1.29	-0.5	-0.75	-0.25
% minutes-of-use pricing – wireline	100%	25%	50%	15%
% minutes-of-use pricing – wireless	100%	5%	10%	0%
Aggregate economic gain(loss)	$41.5-billion	($42.7-billion)	($38.4-billion)	($44.0-billion)

IV. Other Errors and Inconsistencies in the CM analysis

Substitution of more realistic assumptions for the patently flawed foundations of the CM analysis converts the purported "economic benefits" of the *Missoula Plan* into distinctly negative outcomes. However, there are several other shortcomings of the CM model that contributed to its highly exaggerated "economic benefits" projection.

Effect of the Missoula Plan on nonresidential customers. The CM paper – and the accompanying customer impact analyses presented in Exhibit 1 to the Plan – suggest a net decrease in carrier revenues under *Missoula* and hence a net price reduction for the ultimate consumer. But a "revenue neutral" scenario implies a zero-sum outcome – i.e., if some customers end up paying less, then others would presumably end up paying more. What is missing from both the CM paper and from Exhibit 1 is any identification or discussion relative to customers who would end up paying more. Inasmuch as Exhibit 1 is confined entirely to residential wireline and wireless *consumers* and contains no information whatsoever regarding the impact of the *Missoula Plan* upon business, institutional and government telecommunications customers, it would not be unreasonable to surmise that the economic impact upon these omitted customer segments is decidedly *negative*.

The possibility also exists that the CM model has excluded or misapplied certain other sources of increased rates inherent in the *Missoula Plan* that affect the residential segment. In other words, CM may have failed to consider all of the sources of added revenue that would be available to carriers so as to offset the access charge reductions called for under the Plan. In such an event, CM's "economic benefits" assessments would of course be exaggerated.

"Multiplier" effects. After first calculating what purports to be the direct economic gains arising from implementation of *Missoula*, CM then adjust their projection by applying a "Regional Multiplier" so as to capture the secondary effects of those same economic gains.[27] CM state that "Because Missoula plan compensation reforms will increase net overall expenditures on telecommunications by $4.97 billion over its phase-in, these increased expenditures may stimulate greater output and employment in the overall economy."[28] No source or explanation for the $4.97-billion "increase [in] net overall expenditures on telecommunications" is provided; indeed, if the CM demand stimulation projections are accurate, the net increase in telecommunications sector expenditures could well exceed $20-billion.[29]

Multiplier effects are associated with positive and negative change in the overall level of economic activity, and are intended to account for secondary effects. For example, if a company enters a community and builds a new factory employing 1,000 workers, a direct impact of that investment is those 1,000 new jobs. However, those 1,000 people will need houses, buy groceries, eat at restaurants, buy and maintain

---

27. CM cite the Bureau of Economic Analysis, U.S. Department of Commerce RIMS II Multipliers (1997/2002), Table 1.4, for the Telecommunications Sector, which they give as 2.56. Clarke/Makarewicz, at 10; footnote 19.

28. *Id.*

29. This includes the $7.7-billion net gain for ILEC parent companies, $5.82-billion in additional revenues to non-ILEC-affiliate toll providers, and $6.8-billion additional consumer expenditures on wireless service. See Table 2 above.

automobiles, etc., all of which will work to stimulate additional economic activity and employment. Those workers will, in turn, also present economic demand, creating additional economic activity and jobs. So-called *multiplier effects* attempt to capture the total and recursive effects of a change, up or down, in direct economic activity, typically within a given geographic area. CM cite a multiplier of 2.56, which they apply to their direct estimate of $4.97-billion in increase telecom sector expenditures, inflating their initial $41.81-billion figure into a multiplier-adjusted $54.19-billion.

CM's use of a *Regional Multiplier* to assess an economywide impact appears to be misplaced. BEA Regional Multipliers are developed as a means for assessing region-specific or industry-specific effects, which may not necessarily constitute economywide impacts. CM apply the telecommunications sector multiplier to what they describe as increased net overall expenditures on telecommunications that they posit will be made by consumers as a result of the reductions in usage-sensitive prices. But if such increased expenditures arise, they would most likely represent a *shift* in spending away from other economic sectors. In order to develop aggregate economywide multiplier effects, one would need to identify the net increase in telecom spending that is not offset by decreases elsewhere; CM have not done that. This requirement is underscored in the BEA RIMS II documentation:

> When an activity of a new project competes with the existing regional activity, estimating the change in final demand is more difficult, because it is necessary to estimate how much of the new project's output replaces the existing output. For example, suppose a shopping mall is constructed in a region that already has similar shops. If a portion of the sales at the new mall would have occurred at the existing shops in the absence of the new mall, then the final-demand change due to the mall is only the net increase in regional sales. If in the extreme case, all of the sales at the new mall would have occurred at the existing shops, the final-demand change due to the mall is zero.[30]

Another source of multiplier effects – one not considered by CM – arises from the potentially large telecom rate increases that the *Missoula Plan* portends for business, institutional and government customers. Inflating business telecom prices in ways unrelated to the actual costs of providing service has the potential to promote inefficient decisions both as to the choice of telecom service as well as to the use of telecom vs. other inputs in the firm's production process. Excessive telecom expenditures by an enterprise may result in diversion of capital away from what otherwise may be productive undertakings, potentially resulting in a variety of economic losses, including jobs and investments. Just as high energy costs can act as a drag on energy-intensive industries, so too can excessive telecom prices adversely affect telecom-intensive industries, the importance of which to the US economy is growing daily. Unfortunately, the CM model both ignores the increases in telecom prices that *Missoula* may impose upon business customers, and ignores the broader economic implications of such deadweight losses.

Failure to adhere to Missoula's "revenue neutrality" requirement. Separate and apart from its reliance upon flawed and unrealistic assumptions, the CM model appears also to violate a core attribute of the *Missoula Plan – revenue neutrality*. That is, the decreases in ILEC switched access charges are to be

30. Bureau of Economic Analysis, U.S. Department of Commerce, "Regional Multipliers: A User Handbook for the Regional Input-Output Modeling System (RIMS II)," Third Edition, March 1997 ("RIMS II Handbook"), at 9.

offset, dollar-for-dollar, through corresponding increases in the SLC, USF contributions, and the Restructure Mechanism. The Executive Summary of the Plan mades this clear:

> The Plan gives carriers an opportunity to recover lost intercarrier compensation revenues through supplemental sources of recovery. These sources include increased subscriber line charges ("SLCs") as well as a new Restructure Mechanism, which is designed specifically to replace switched carrier-tocarrier revenues lost by carriers participating in the Plan and not otherwise compensated for that loss through end-user charges.[31]

AT&T has undertaken to model the dollar impacts of the various rate changes called for in the Plan. In describing its Model, AT&T notes:

> The Missoula Group recognizes the importance of understanding the impacts of the proposed plan including estimating the size of the Restructure Mechanism. The main objective of the Modeling is to calculate the annual amount of the Restructure Mechanism (RM) that will be needed when switched access rates reach their final levels under the new plan. In an effort to develop the best estimate possible, the group undertook two independent modeling efforts. One modeling effort was led by AT&T experts; the other modeling effort was led by the Rural Alliance experts.[32]

As Table 10 indicates, however, the data inputs to the CM model are decidedly *not* revenue-neutral. Ignoring the effects of demand stimulation – which was not considered in the AT&T Model and is not accounted for under the *Missoula* restructuring – CM put total post-transition access charge reductions at $8.4-billion offset by only $6.8-billion in SLC, USF and RM increases – i.e., an ongoing annual net revenue decrease of some $1.6-billion. When their demand stimulation adjustments are factored in, the net annual revenue decrease escalates to $2.4-billion following the completion of the transition. Obviously, consumers will benefit from a net decrease in payments to telecom carriers, but no such decrease is contemplated in the *Missoula Plan* itself. CM neither acknowledge nor explain the basis for this fundamental disconnect.

---

31. the *Missoula Plan Executive Summary*, at 1. The use of "carriers" here is overly broad, since "opportunity to recover lost intercarrier compensation revenues through supplemental sources of recovery" is not being afforded to, or assured for, CLECs.

32. Based upon the results of the AT&T and Rural Alliance modeling efforts, total RM, including CLEC RM, is expected to fall in the range of $1.4- to $1.6-billion. In addition, the *Missoula Plan* contemplates increases in other Universal Service programs totaling $725-million. Including the projected SLC increases, this would result in roughly $6.9-billion, which would then exceed the ILEC access charge reductions by about $900-million. Executive Summary, at p. 13 and footnote 12.

Table 10

The Rate Rebalancing underlying the Clarke/Makarewicz Model is Not Revenue Neutral

After phase-in period	Missoula Group--AT&T model	CM-no demand stimulation	CM-with demand stimulation
Decrease in annual ILEC access charge revenue	$6-billion	$8.4-billion	$9.2-billion
Increase in SLCs	$4.7-billion	$6.8-billion	$6.8-billion
Increase in USF/RM	$1.3-billion		
Net increase (decrease)	$0	($1.6-billion)	($2.4-billion)

V. Conclusion

The *Missoula Plan* for intercarrier compensation reform will almost certainly impact consumers economywide, and assessing these impacts (whether negative or positive) is a critical element in evaluating the overall reasonableness of the Plan. The model as developed by Clarke and Makarewicz could potentially be useful for gauging the end-result of the *Missoula Plan*, but only if the underlying assumptions and input data were valid, which is clearly not the case. Here, the specific scenario they have examined is based upon fundamentally flawed assumptions and data (some of which directly contravene the Plan itself), producing a grossly overstated estimate of the economywide benefit of the Plan.

Critical to the CM model is its requirement that 100% of the access charge reductions prescribed by *Missoula* be flowed through to consumers in the form of lower prices. However, the Plan itself provides for no such mechanism, and the prevailing state of market concentration and integration make such flow-through extremely unlikely. But even if such flow-throughs occurred, the projected benefits would not occur because the CM model is riddled with other unsupportable assumptions. CM assume that states adopt and immediately implement voluntary *Missoula* access charge reductions. CM rely upon own-price elasticities of demand for toll and wireless services that were developed in the distant past and that are clearly no longer applicable to current pricing and market conditions. CM also assume that all toll and wireless minutes are priced and sold on a per-minute basis, ignoring the preponderance of block-of-time and unlimited usage plans. All of these assumptions, individually and in combination, contribute to a grossly exaggerated assessment of *Missoula's* economic benefits. CM also misapply regional multiplier effects that further inflate those overstatements of consumer benefits. When the various flawed assumptions are replaced with more realistic inputs, rather than showing a $54-billion consumer benefit, the model suggests that adoption of the *Missoula Plan* could result in massive *negative* economic impacts in the range of $39- to $44-billion. Finally, if incumbent LECs and their parent corporations are enabled via *Missoula's* "revenue-neutrality" requirement to maintain – and, in fact, to significantly *increase* – their already excessive rate and earnings levels, they will have the ability to maintain and enlarge their already formidable economic war chest so as to cross-subsidize entry into new markets and new technologies, further distorting economic choices as between incumbent and competitor services. Clarke and Makarewicz have not accounted whatsoever for this potentially enormous source of economic loss.

EXHIBIT B

at&t

Search

AT&T CallVantage® for Small Business

AT&T CallVantage® Voice over IP Service

Get big-business calling features and services at a price you can afford. All you need: a high speed Internet connection, ordinary phones, and AT&T CallVantage® for Small Business. Learn More about how we can help your business, with service on up to four lines.

Small Business

AT&T CallVantage Home

About AT&T CallVantage

Plans & Pricing

International Calling

911: It's Different

Frequently Asked Questions

Subscriber Agreement

Not a Small Business customer? **Visit our Residential site.**

Unlimited long distance and local calling

$50.00 [illegible]

Order Up to Four Lines

Need More Than Four Lines?

Interactive Demo

See and hear AT&T CallVantage service come to life in our interactive demo

View Demo

Order Cart

Existing Customers

- Access your account

†High speed Internet required, charges not included. There is a $29.99 activation fee and a $9.95 non-refundable shipping and handling fee applicable if the 2 line Telephone Adapter is shipped to you. The non-refundable shipping and handling fee for a 4 Line Telephone is $14.95. For 1-2 Line Customers: If you obtained the Telephone Adapter from AT&T at no charge, and you cancel or disconnect your service or order for service within 1 year of ordering date the Telephone Adapter must be returned and received by AT&T within 16 business days of cancellation date. If the Telephone Adapter is not received by AT&T within 16 business days, a $29.99 disconnect fee applies. For 3-4 Line Customers: If you obtained a 4 Line Telephone Adaptor directly from AT&T at a charge and you cancel or disconnect your service or order for service within 1 year of the ordering date, the Telephone Adapter may be returned and received by AT&T within 16 business days to receive a refund of the amount paid to AT&T for the adapter. 3-4 Line Customers canceling or disconnecting service less than one year from date of order will not be assessed any additional charges if the Telephone Adapter is not returned and will receive no refund or purchase costs. International calls billed at additional per-minute rates, not included in free offers. Universal Connectivity Charge and other state and federal taxes and surcharges apply. Service will not function during high-speed Internet and/or electrical power outages. Not compatible with security systems (burglar or fire) or medical monitoring equipment. Billing is by credit card only. Not available in all areas. Service's 911 calling operates differently from traditional wireline 911 service. For correct emergency call routing, the Service Address provided to us MUST correspond to the physical location of your AT&T CallVantage® service phone. Click "911: It's Different" button above for important information about 911 service. Click "International Calling" to obtain international rates. When dialing into service remotely, you may incur additional access charges for non-local calls, hotel service charges or cellular mobile charges. International calling: Higher rates may apply for calls terminating on mobile phones or other wireless devices.

AT&T Digital Phone Service℠

AT&T CallVantage service is a revolutionary digital voice service based on Voice over Internet Protocol, or VoIP technology.

Sign up now and you can get unlimited local and long distance calling in the U.S., Canada and Puerto Rico, plus enjoy low international rates, great service and exciting features, including parental controls.

AT&T CallVantage Home
About AT&T CallVantage
Plans & Pricing
About AT&T CallVantage Softphone
International Calling
911: It's Different
Important Info And FAQs
Subscriber Agreement

Not a Residential customer? Visit our Small Business site.

$24.99 PER MONTH* FIRST MONTH FREE

AT&T CallVantage® Service Plan
Unlimited local and long distance calling in the U.S., and to Canada and Puerto Rico.

View All Plans | View Plan Details

$49.99 PER MONTH*

AT&T CallVantage® 2-Line Plan
Line #1: Unlimited local and long distance calling in the U.S., and to Canada and Puerto Rico.

Line #2: Unlimited local calls and 500 long distance minutes (4¢ per minute thereafter).

View All Plans | View Plan Details

$19.99 PER MONTH*

AT&T CallVantage® Local Plan
Unlimited local calls and 4¢ per minute on long distance calls.

View All Plans | View Plan Details

Already a customer?
Access your AT&T CallVantage account
Questions? Log in to the Help section

High speed Internet required; charges not included. $29.99 activation fee applies. $9.95 non-refundable shipping and handling fee applies if Telephone Adapter is shipped to you. $29.99 disconnect fee applies if service or order for service is canceled or disconnected less than 1 year from the date you placed your order for service and Telephone Adapter (if obtained directly from AT&T without charge) is not returned to and received by AT&T within 15 business days of cancellation or disconnection. International calls billed at additional per-minute rates; not included in free offers. Universal Connectivity Charge and other state and federal taxes and surcharges apply. Service will not function during high speed Internet and/or electrical power outages. Not compatible with security systems (burglar or fire) or medical monitoring equipment. For residential customers only. Credit card billing only. Not available in all areas. **Service's 911 service operates differently from traditional, wireline 911 service. For correct emergency call routing, the Service Address provided to us MUST correspond to the physical location of your AT&T CallVantage service phone.** Click "911: It's Different" button above for important information about 911 service. When dialing into service remotely, you may incur additional access charges for non-local calls, hotel service charges or cellular/mobile charges. **AT&T CallVantage Service Plan:** 1st month free offer expires 6/30/08 and is available online and from some AT&T stores only. **AT&T CallVantage Local Plan:** If a non-local number is used for the Locate Me, 3-Way Calling or Call Forwarding features, per-minute long distance charges apply. **AT&T CallVantage 2-Line Plan:** Unlimited local and long distance calls on 1st line; unlimited local and up to 500 minutes long distance calls on 2nd line.

Waiver of minute caps by AT&T at any time shall not restrict the right of AT&T to enforce such caps thereafter. **International calling:** Higher rates may apply for calls terminating on mobile phones or other wireless devices. Click "International Calling" to obtain international rates.